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Editorial Comment

Disinheritance of Dependants By Testator

A recent action in the English courts called public attention to the fact that in a country credited with a highly developed social conscience it is still lawful for a man of means to leave penniless on his death those whom during his life he is under legal obligation to support. The faith that "an Englishman's home is his castle" dies hard, and in the process of dying lurks in odd corners. During the past five years three private members' bills have been introduced into Parliament with the purpose of bringing the English law in this respect into line with the more humane law of Scotland which provides that a man can dispose freely of only one-third of his estate, that at least one-third must go to the widow and at least one-third to the child or children. None of these bills has received government support and the fate of all three, including the most recent one which is still before the house, appears to be the usual fate of private members' bills affecting large social issues, i.e., disappearance after second reading. It would seem that successive governments are reluctant to deprive a citizenry, whose freedom in most directions is being steadily curtailed, of the final exquisite satisfaction of revenge after death upon a family which during life was a source of acute disappointment or vexation.

In Canada, the law has long placed restrictions on the disinheritance of wives by providing the widow with a right of dower, i.e., a right to share on her husband's death in the income from any real estate of which he dies possessed. This safeguard may have been effective in the early days of the country when life was predominantly rural and agrarian and when real estate holdings would almost inevitably constitute a large part of most estates. With increasing industrialization and urbanization real estate holdings of the average citizen tend to diminish and it was thus often possible for a man to disinherit his wife completely. Moreover at no time were there any restrictions of any kind on the disinheritance of children.

In Ontario the needed reform was effected in 1929 by *The Dependants' Relief Act* and similar legislation has been enacted in other provinces. Under the Ontario law if the court is satisfied that a testator has so willed his property that adequate provision has not been made for the future maintenance of his dependants (wife or husband and children under sixteen years or incapable of self-support), the court may order an allowance sufficient to provide such maintenance. The amount of the allowance so ordered is not to exceed the amount to which the claimant would have been entitled if the testator had died intestate, and the aggregate of the allowances is not to exceed one half of the net residue of the estate. The elasticity of this procedure seems preferable to the rigidity of the Scots system with its arbitrary division into three equal parts but it might yet result in adequate relief of the dependants of a man of small means. The social value of legislation of this kind is to be measured by its influence upon testamentary dispositions, rather than by the number of applications which are made under it; and so it is not possible to assess the results of the law during the few years it has been in operation. Its existence upon the statute books does indicate that, in one respect at least, Canadian social legislation is ahead of that of England.

The Accounting Profession and the Economists

Unlike other scientists the economist cannot check his deductive reasoning by experiment but is entirely dependent, in this connection, on his own observations and on the recorded observations of others. Ac-

counting statements are one source (and an important source) of this latter type of material and economists are making much greater use of these statements today than they did a decade ago. But if the economist is to make *proper* use of accounting material he must understand accounting technique and terminology and he must also have some knowledge of the workings of the accountant's mind. The second part of this qualification is the more difficult to come by and can only be gained by walking and talking with accountants. And yet it is essential that the economist should know not only what procedures the accountant follows, but also (and this is not necessarily the obvious thing) what end the accountant, and the business man who actuates the accountant, thinks these procedures are serving. The accountant, for example, adopts a certain procdure for the determination of what he calls "net income." The economist wants to know what this procedure is, and also what the accountant thinks he has discovered when he has computed this "net income"—in other words the accountant's idea of its practical significance. It is likely that full and free discussion of common problems would not only inform the economists but that they would also provide a valuable stimulus to the accountant, for the accountant is a busy man immersed in practical problems demanding immediate and often impirical treatment. He rarely has time to get above his work to ask himself what it is all about and what is the real economic and social significance of the concepts which he has adopted. And yet it is only by developing and retaining a capacity for theorizing that the outstanding members of the profession throughout its history have been able to make the contributions to accounting practice which collectively constitute the progress of the art of accounting and the progress of the accounting profession.

Towards Uniformity in Company Law

It is improbable that uniformity in detail of the corporation laws of the ten jurisdictions in Canada which have power to incorporate companies will ever be achieved. There is reason to hope, however, that in the near future some uniformity in the general principles of the formation of companies, their regulation, accounts and audit may be established. The sub-committee of law officers of the Dominion and provinces which was appointed

last winter has been quietly working on the problem and is ready to report to a plenary session. The nature of the report has not, so far, been made public but business men in general and the accounting profession in particular will hope that the technical difficulties and sectional rivalries have not precluded a substantial advance towards a simplification which would mean much in dollars and cents to Canadian industry and commerce.

Practical Schedule For Income Tax

Under this title Mr. Irving Fisher, Professor Emeritus of Economics, Yale University, continues his personal campaign against the capital gain tax of the United States and in favour of an income concept whose main defect is its complete logicality.[1] "Income consists of the flow of services rendered through a given period of time" and accordingly is to be measured as "[conventional] income after sayings are taken out." Put in another way the amount which Professor Fisher considers should be subjected to income tax is the amount *spent* by the taxpayer during the tax period on the purchase of consumption goods, and not the amount of money income received. The adoption of this concept would render subject to tax the net use-value of the dwelling house owned by the taxpayer, of his automobile, of his house furnishings and also any amount by which his capital receipts exceeded his capital expenditures. Thus, in reference to this last item, if John Smith owns $200,000 worth of 5% bonds which mature and are repaid during the year he will be taxed on any part of the $200,000 which he has not either re-invested or kept on hand as unused cash, taxed that is to say on the part which he has spent on personal use goods—food, clothing, entertainment, etc. Likewise if Tom Brown receives $10,000 in dividends but manages to save the greater part of this he will be taxed on the balance only, that is to say on the portion spent on personal use goods. "Thus," says the author, "the simple service—or use—concept automatically adjusts itself to all these varying realities: to the spendthrift who, for a season, gets more income than thrifty people do; to the miser who gets less; to the fortunate beneficiary of

[1]See the July issue of *The Tax Magazine*, published by Commerce Clearing House, Inc., 205 W. Munroe Street, Chicago.

windfall income; to the unfortunate victim of ill luck; to the dweller in a city flat who pays for every consumption service; to the isolated farmer who supports himself without much use of money."

The practicability of these proposals may be questioned (although Professor Fisher himself claims that his income concept is much more practical than any in actual use by taxation authorities and that it would greatly reduce the opportunities of tax evasion). The proposals appear to be more relevant to a country which is labouring under a capital-gain tax than to one like Canada which excludes capital gains from taxable income.

FOOD COST ACCOUNTING

For Hotels, Restaurants and Hospitals

By J. R. Hendry, Chartered Accountant, Montreal

THE evolution of the modern manufacturing plant with a capacity many times greater than its predecessor of, say, thirty years ago has brought with it a very definite change in management methods. The owner-manager of earlier days knew each man, each tool and each machine process in his organization and, probably, having every movement under close personal supervision, his accounting system to meet his needs was simple. Under the urge of competition the modern plant not only produces more goods but produces them in a great variety of quality, size and pack, and in doing so uses more complex processes with less spoilage and waste, more efficient and less costly manual fabrication methods and finally seeks to place its product in the hands of the consumer with the minimum of selling and distribution cost. To do these its cost and accounting systems have of necessity become more complicated, more adequate and (it is to be hoped) more accurate.

Rising costs and increased competition have made it exceedingly difficult to manufacture and sell the product of industry at a profit. Increasing cost of raw materials has prompted the avoidance of waste and more economical methods of operation. Competition has brought more intensive sales methods, and the limits which it has also placed on selling prices have given definite impetus to more economical manufacturing and selling methods.

The result of these influences has been a demand for more accurate and detailed information of the cost of manufacturing and selling the various products.

While this development has been taking place in manufacturing plants a similar evolution has taken place in hotels and restaurants. The hotel and restaurant of today have entered the realm of "Big Business." Not only has the size of individual establishments been greatly increased but many are linked up in chain organizations operating in many locations. The increased size of industrial plants and their concentration in economically strategic locations have created a greatly increased clientele for restaurant and hotel. Lunch rooms and soda fountains have sprung

up in large numbers to share in the rich harvest, and competition has become exceedingly keen. Many of the factors which have forced the management of industrial enterprises to seek more detailed accounting information as to the costs of production have been present with equal force in the operation of hotels and restaurants and have likewise made the restaurateur realize that only through a detailed and complete knowledge of the costs in his own business can he meet competition successfully.

Purpose of Cost System

In the industrial field such detailed information is secured by a cost accounting system which gives particulars of the various elements of cost for each job or product manufactured, the cost of operating each manufacturing department, the sources of profit or loss and the results of the operation of the entire plant. It also permits the analysis and comparison of costs as between one period and another, as well as between the costs of similar products manufactured by different processes. In the hotel and restaurant field similar information is secured through the installation and operation of a food cost accounting system or "Food Control," as it is sometimes called.

The purpose of food cost accounting or food control is to assist the management in keeping the cost of food consumed at the lowest possible point consistent with the policy of the management as to quality and size of portions. While a food control system may bring out the fact that portions are too large it is not the aim of the system to reduce portions. Nor is it the purpose to reduce costs by lowering quality—no food control system is needed to do this. The moral effect of the installation of the system often results in a lowering of costs through the elimination of waste but the system cannot of itself effect any change. The system should produce detailed records of daily costs and comparisons of costs between periods which will enable the management intelligently to control purchases and stores, establish prices and determine policies. Food control is not a panacea for all the ills of the hotel and restaurant business but accurate records of food costs, prepared daily and interpreted correctly by an efficient executive will form a basis for intelligent and successful operation.

The late Robert Dollar, head of the steamship line bearing his name, is reported to have said that he ascribed his business success largely to his ability to read and understand figures, but he added, "I first make sure that figures submitted to me upon the strength of which I base my judgments are correct." In no department of an enterprise is the need for correct records greater than in the cost department. Food cost records must be proved and this is done by controlling the cost accounting records through the general books of account. The cost statements show the same results as the general operating statements—only in much greater detail and with a different grouping of the items.

In order to secure adequate food control, the following information must be available—

1. Distribution of daily food costs
2. Distribution of daily food sales.

From these records a "Daily Summary of Commissary Operations" is compiled showing cost and sales for the day distributed by commodities and departments, together with accumulated totals for the period to date. In addition such useful information as number of covers served, percentages of cost to sales by commodities and by departments, comparisons with the same day of the previous week and with the same period of the previous year, is included. From this record the executive officers can see the various changes which have taken place and are, therefore, in a position to take steps to correct weaknesses when required, without the necessity of lengthy preliminary investigations.

Accounting for Materials

Before accurate daily food costs can be obtained all merchandise must be under strict control and issued to the various departments on proper authority only. Materials are worth the money spent for them and must be guarded and accounted for with as much care as the money that was spent in acquiring them. Materials which are not controlled are at the mercy of the careless or dishonest employee to be used or misused according to the whim of the moment.

A clean, well ventilated store room filled with adequate shelf space and storage bins, is essential for economical storing and handling of merchandise. Deterioration can

be as costly as pilfering. Goods should be arranged in the store room systematically, easily accessible and according to a well devised plan, so that any commodity can be located with a minimum of effort. The store should be in charge of a storekeeper or steward, who is responsible for the receipt and issue of all stores and accountable for any shortages.

Merchandise in the store should be controlled by a Perpetual Inventory Record, (Form No. 1), consisting either of a card system or a stock ledger. A card or sheet must be made out for each commodity handled and, in the case of canned or packaged goods, separate cards are made out for each size purchased. These are printed with space at the top for a full description of the goods, including size or quantity in each container so that items can be readily identified. In addition space should be provided for recording the maximum and minimum amount of stock to be carried at any time. The body of the card should be divided into three sections, "Received," "Issued" and "Balance" and sufficient columns printed in each section to record date, invoice number, quantity, unit price and total value.

Food control must start in the purchasing department and the same care exercised in placing orders as will be exercised later in using the goods. All purchases should be made by the executive in charge of the purchasing department, and orders should be issued for all purchases made. Purchase orders should be made out on specially printed and consecutively numbered forms and completed with a full description of the goods required and showing quantity and unit price. All orders should be signed by the official authorized to make purchases. Orders should be prepared in triplicate, one copy sent to the supplier, one copy retained by the purchasing department for reference and one copy sent to the storekeeper. The store clerk checks the goods when received against his copy of the purchase order and the supplier's invoice and enters the date, purchase order number, quantity received, unit price and invoice value in the "Received" section of the perpetual inventory records for the particular goods received.

While the ideal arrangement is to receive all goods at the storeroom and to issue them on requisition as required this is seldom possible in practice except in a few large

establishments. It is usually the case that perishable goods are purchased in quantities sufficient only for the day's requirements and delivered direct to the kitchen for lack of refrigerator storage space to handle large quantities. In this case the receiving clerk checks the goods when delivered and enters the quantity, unit price, description and invoice value on a "Summary of Direct Food Purchases Report" which at the end of the day is totalled and forwarded to the food cost accountant.

All invoices, when checked by the storekeeper, are stamped to show that quantities, quality and prices, are correct and then forwarded to the accounting department with related purchase orders attached where they are entered in the purchase journal and distributed to "Direct Food Purchases" or "Stores Food Purchases" and form the basis of the monthly debits in the general ledger.

When goods are required from stores the department head completes a "Stores Requisition Form" in duplicate with the quantity and description of the goods required and sends it to the storekeeper who inserts the unit prices, which he finds in the perpetual inventory records, and extends the total cost of each item on the requisition. After delivering the goods called for he enters the date, requisition number, quantity, unit price and total value in the "Issued" section of the perpetual inventory records and brings forward the quantity and value of the goods remaining in stock in the "Balance" section. At the end of the day the requisitions are totalled, summarized by departments and, after having been entered on a "Summary of Stores Issued Form" are forwarded together with a copy of the summary to the food cost accountant. From the "Summary of Stores Issued" and the "Summary of Direct Food Purchases," already referred to, the cost accountant prepares the "Distribution Sheet for Daily Food Cost," Form No. 2, by analyzing the direct purchases and the issues from stores into suitable control groups by departments in which the goods were used.

Since goods are sometimes transferred from one department to another it is necessary to have interdepartmental requisitions to record these transfers. These transfers do not affect the total cost of food but only the division of the total cost between departments so that no record is needed

in the general ledger accounts. Effect is given in the "Distribution Sheet for Daily Food Cost" for interdepartmental transfers by deducting the amount transferred from the receipts of the department from which the transfer is made and adding it to the receipts of the department which receives the goods.

Control of the merchandise in the store is secured by making a physical count of the quantities on hand and checking with the balances which ought to be on hand according to the perpetual inventory records. Any differences should be traced and when satisfactorily accounted for, adjusting entries made on the inventory cards in which the differences were found. The total value of the goods in the store should be compiled by totalling the values shown in the "Balance" section of the perpetual inventory records. This amount should agree with the balance in the "Stores Food Control" account in the general ledger which has been debited with the cost of all goods purchased and put into store and credited with the total stores issued at cost. Any wide variation should be investigated and the necessary adjusting entries made in the general ledger accounts to bring them into agreement.

In compiling the "Distribution Sheet for Daily Food Cost" no account is taken of the inventories in the kitchens, pantries or other departments. Experience has shown that these inventories vary little from day to day and, since the amount of work involved in taking inventories daily is out of proportion to the benefits to be derived, inventories are ignored in making up the daily figures and to the extent that these fluctuate from day to day the daily food cost is inaccurate. All department inventories should be taken monthly and the monthly statements adjusted to take into account the net change in the inventories during the month.

Accounting For Revenue

As control of income is just as important as control of materials, every item of food issued from the kitchen and pantries should find its way into revenue either as cash or as a charge to accounts receivable, where part of the business is on a credit basis, or as a charge to employees' meals. Some people take a special delight in cheating restaurants, and many methods are tried by unscrupulous patrons and dishonest waiters. One is to give a small order

and, after receiving a check for it, order a full course dinner and ask to have it all put on one check because the first check is lost. When leaving only the small check is paid. Another is to have the waiter undercharge and to give back part of the saving in a liberal tip. Several people eat together and get separate checks and when leaving pay only one check with the explanation that "they are all on the one check." With proper supervision such practices can be detected and stopped. Waiters should report to the supervisor or cashier when a patron claims to have lost a check, giving the number of the new check issued. Undercharging can be controlled through the operation of a food checking system, while, where more than one person is served and it is the practice to make only one check, the number served should be shown on the check.

As already stated all food issued must be accounted for and a checking system is necessary to accomplish this. There are many systems in use, some of which are more effective than others, but there is no one system that is best in every case. Conditions vary greatly in different establishments and only after a careful study of all the conditions existing in a particular restaurant can the most effective system be determined.

No matter what checking system may be used the first prerequisite to control is the numbering and control of the restaurant checks. Where checks are bound in books each book should be examined to see that the correct number of checks is included and that no duplication of numbers has taken place in printing. As checks are issued to the waiters a record of the numbers is made on sheets kept for the purpose and the waiter signs for the checks he receives. Where checks are not bound but are handed out to the waiter individually as required, check numbers are entered consecutively on a record sheet which the waiter signs against the number of the check which he takes.

The simplest system, which aims at control, is to have the waiter write out his own check in detail including the price and give it to the customer who pays the cashier on leaving. The cashier then rings up the amount received on the cash register and at the end of the day the total checks should agree with the total receipts as shown by the register. While this system provides a certain amount of

control over the waiters and the cashier and makes it possible to fix the responsibility for certain shortages, it has the very serious disadvantage of providing no means of checking food issues from kitchen and pantries to sales.

Checking systems can be classified into three groups according to the method of control: 1. checker's sheets; 2. duplicate checks, and 3. register machines.

The checker's sheet system consists in having a sheet with columns for each waiter and a set of rubber stamps with prices in duplicate. The waiter fills his tray in the kitchen and pantry, writes up his check but does not include prices and, when leaving the kitchen, takes his tray and check to the checker who checks the items on the tray and, after placing the check alongside that waiter's column on his sheet, stamps the prices on the check and the sheet with the duplicate stamp.

In the duplicate check system no checker is employed. The waiter puts a duplicate slip under the check and writes out the order inserting the prices. He then leaves the duplicate in the kitchen as a receipt for the food received. Since all the dishes are not received at the same place the waiter has to make a duplicate for each department from which he gets food. As soon as he has listed all the items on the check that he gets from one department he takes out the duplicate and inserts another and continues to list the items he will receive at the next department and so on, making a list for each department. Thus he leaves a record in each department of what he receives.

This system sounds well in theory but works well in practice only in the smaller restaurants where the chef has plenty of time to watch everything that leaves the kitchen and pantries. Since the duty of the chef is to prepare good food at a reasonable cost and serve it attractively the work of routine checking should not be imposed on him. Where volume justifies the expense it is more profitable to employ a food checker whose time is less costly than that of a high priced chef.

The register machine does not provide for a record of the sales of each waiter except as is provided by the waiters' checks. The method is the same as when checker's sheets are used, but, instead of stamping the prices on both the check and the sheet, the checks are inserted in a register

machine which stamps the price on the check and on the tape and automatically accumulates the totals.

Regardless of the checking system used the cashier should keep a record of the checks turned in by summarizing the sales of each waiter on a columnar sales sheet. All checks must be accounted for and any missing numbers checked to the waiter to whom they were issued. The total sales as shown by the sales summary should agree with the total food charged out from the kitchen and pantries as recorded on the checker's sheet, summary of duplicate slips or register machine according to the system in use.

In cost accounting for industrial concerns costs are applied to the units produced on the basis of the amount of material and labour entering into their production with an estimated amount added to cover overhead expense. In restaurant and hotel costing such a system is impractical if not wholly impossible. Labour cost and overhead expense are not taken into account in the "Distribution Sheet for Daily Food Cost," which deals only with the cost of materials. Labour and overhead expenses are analyzed by departments, and comparisons made between departments and periods and adequate control secured. The cost of material entering into individual sales units is not calculated because of the difficulty of breaking down the unit into its component parts and distributing the cost of the materials used over the parts. For example an order of lamb chops would be divided into "Lamb," "Potatoes," and "Vegetables" and the cost of each item used in the preparation of the dish determined, which would result in constant weighing, measuring and recording in the kitchen. It is obvious that such a cost system would be impossible to operate.

It is not the aim of food cost accounting to find out the cost of individual dishes but to find out how much is received from the sale of certain units and groups of units, of which the cost is already known, and to determine what profit has been earned in the various groups.

Sales are analyzed from the itemized restaurant checks. Each item appearing on the check is recorded on the "Distribution Sheet for Daily Food Sales," Form No. 3, under the item and in the group to which it applies. After all

the checks have been analyzed and the number of portions entered in the portions column the total selling price is calculated by multiplying the number of portions by the unit selling price, and entered in the amount column. Combination dishes are entered in the group of the main ingredient; waffles and bacon, for example are classified as waffles. The total sales of waffles and bacon are then determined and the excess of the sales price over the same number of orders of waffles is inserted in red in the "Transfer" column in the pastry department section and an entry for the same amount is made in black in the same column in the miscellaneous provisions section under bacon. In the case of such items as patties an estimated amount is applied as the selling value of the pastry shell and a transfer made to the pastry department to cover the estimated revenue from the sale of pastry shells, the corresponding entry being made in red against the item in which the sale of patties appears. After all transfers have been made the "Net Sales" column is completed, totalled by groups and summarized. This total should agree with the total shown on the sales summary prepared by the cashier from the restaurant checks.

The net sales are now transferred to the "Daily Summary of Commissary Operations," Form No. 4, to which has been transferred the cost from the "Distribution Sheet for Daily Food Cost" thus completing the cost and sales for the "Day" column. The total cost and sales are then calculated and entered in the section headed "To Date."

Special Methods for Hospitals

Hospitals lack the profit stimulus which has been present in industrial enterprises with the result that detailed accounting and costing methods have not been developed to the same extent. The notion of tying up the revenue from services rendered with the cost of these services, an idea fundamental in the management of business, has not penetrated very far in the hospital field. More than twenty years ago Joseph E. Stone writing of his findings in an investigation of hospital accounts and financial control in some British hospitals, said, "In the same way that hospitals are being asked to account for revenues they are also being required to account for expenditures made. However, merely accounting for expenditure is not sufficient; the

economy of issuance and use may be much greater than the economy of purchase and this requires control of stores through proper orders for goods issued. Departmental distribution of these stores compiled from requisitions enables the executives to isolate abnormal use of supplies and aids in comparisons between one department and another, and is altogether more useful than the tabulation of the original purchases........ It can then be determined what departments are operated at a profit or at a loss........ The fact that departments are not paid for their work is not necessarily their fault........they may be doing service at very reasonable cost but through economic conditions the percentage of indigent patients may be great with the result that the actual revenues collected may bear no relation to total services rendered."

The same observations can be applied to Canada today. The years of depression through which we have passed have put a heavy strain on hospital finances. Not only has income from investments and endowments undergone considerable shrinkage but ordinary revenue from paying patients has also declined through inability of a large number of people to meet the full cost of hospitalization. At the same time many of the expenses of a hospital are fixed and cannot be reduced to meet declining revenue, while others tend to mount through the increasing number of indigents seeking medical care in clinics and outdoor patient departments.

Much of the criticism of hospital costs could be avoided if hospitals were prepared to substantiate the results of their work by showing by means of percentages, costs and other figures that charges for services had been too low in certain cases, government grants and allowances insufficient to cover the cost of free patients and that donations received from public spirited citizens were economically and wisely applied. From such information the public would fully realize the tremendous burden hospitals are bearing as a result of economic conditions which place a considerable number of people in a position where they are unable to afford vitally necessary treatment.

The same methods as have been outlined for the control of purchases, issues and inventories in restaurants and hotels are used in hospitals but the basis of food costing

differs because of the essential difference between selling meals to the general public and feeding hospital patients.

Since hospital charges cover complete hospitalization of patients no good purpose is to be served by allotting a portion of the total charge to feeding and then applying the cost of food to the estimated revenue from food to find out whether a profit has been made or a loss incurred. The most valuable measure of the efficiency of commissary operations in hospitals is the food cost per patient day and this should be computed daily for private, semi-private and public ward patients, staff, doctors and help and further subdivided to show cost by wards. The food cost per patient day is the cost of the food used to feed a patient or member of the staff for twenty-four hours.

It is the usual practice in hospitals to consider the day as starting at midnight and to charge every patient in the hospital for a full day if admitted anytime within the following twenty-four hours. After midnight a report is made to the office by the nurse in charge of each ward giving full details of the number of patients in the ward and this is used as the basis of making charges to patients' accounts. When this report is made a "Diet Slip" should also be completed with details of the meals required for the next twenty-four hours. These diet slips are sent to the dietitian in charge of the kitchen and serve as the basis for the issue of stores and the preparation of meals.

Public ward patients have no choice of diets but are supplied with a standard diet according to the requirements of particular cases and as ordered by the doctor. Each diet is given a number and the nurse in charge inserts the number of patients in her ward who are to receive the different diets and, after noting any extras which may have been ordered, sends the diet slip to the kitchen. In the case of private and semi-private patients where there is a choice of meals the menu for the following day is sent to each patient in the afternoon and after having been marked with the meals chosen is returned to the ward nurse who makes up a summary of the meals required for the ward and sends it to the kitchen.

Diet slips are then analyzed into ingredients and summarized and a stores' requisition prepared for the total stores required for the day. After the storekeeper issues

the stores he enters the unit prices on the requisition, extends the cost of each item and posts the details in the "Issued" section of the perpetual inventory cards. The ward summaries are then priced, the cost of each ingredient is extended and the total cost computed. The total food cost for the day is then entered on the cost summary together with the total number of patients and extended in columns to show food cost and number of patients for each ward, food cost and number of patients in private wards, in semi-private wards, in public wards and the same information for doctors, nurses and help. The total number of patients fed as shown by the summary should agree with the number of patients reported to the accounting office and any difference should be traced to the ward reports. Totals are carried forward daily on the summary thus giving the accumulated totals for the period to date as well as the daily figures.

A careful analysis of patient day costs and comparisons between wards and periods will result in intelligent control of kitchen operations and elimination of waste through fuller knowledge of detailed ward food costs.

Depreciation

"Depreciation is no more than a periodic amortization of the cost of an asset over the period of the useful life of such asset to the organization which owns it." From the day equipment is purchased it begins to depreciate and its value continually diminishes, with greater or lesser rapidity according to its nature and use, until it reaches a point where it has no further useful value to its owners, except perhaps as scrap. As Montgomery puts it in *Auditing Theory and Practice,* "Depreciation is due to the possession and use of the assets; it is certain to occur and therefore it is a part of the cost of operation."

In determining the amount to be charged the question should be considered only in connection with the initial cost of the item to be depreciated. The fact that the replacement value of the asset has increased or decreased since the time of its purchase has no bearing on the amount to be provided. The initial cost less the probable scrap value at the end of its useful life is the amount that must be charged to operations during the period of its usefulness. In estimating possible useful life the question of obsol-

escence must be considered as well as ordinary wear and tear. The risk of obsolescence is very great under modern competitive conditions and rapidly changing methods, and unless ample provision is made for keeping equipment up-to-date earning capacity may be severely diminished. Since it is impractical to establish individual rates to cover each item of equipment, similar classes should be grouped and estimates made to cover the whole group.

The problem which confronts the accountant is how to apply this loss in value equitably to the various periods during which the asset value is being used up. While there are many methods of determining the amount to be charged for depreciation, it is not the purpose of this paper to deal extensively with all the methods now in use. Any good text book dealing with the subject may be consulted for a more detailed study.

For the purpose of providing depreciation, kitchen and dining room equipment is divided into two groups; in the first: ranges, ice boxes, mechanical devices, machinery, pots, pans, coffee urns, etc., and in the second: linen, glassware, china and silverware.

The simplest and most commonly used method of providing depreciation for group one is the straight line method. Under this system the total amount to be depreciated is divided equally over the years of usefulness of the asset and an equal amount charged to operations each year. This method is probably as accurate and satisfactory as any when applied to this kind of equipment. Another method uses a fixed percentage but applies this annually on the net value of the asset after deducting all depreciation already written off. Under this system a large amount is provided in the first year and successively smaller amounts in succeeding years. The argument in support of this method is that the cost of repairs and maintenance is lighter in earlier years but heavier in later years.

No expected life is determined for linen, glassware china and silverware. Instead an inventory is taken at the beginning of the period and the cost of all equipment purchased during the period added. At the end of the period the equipment is reinventoried and the difference between the opening inventory plus purchases and the closing inventory is written off to the operations of the period.

Because of the saving in purchasing in large quantities many restaurants and hotels purchase large supplies of linen, glassware, etc., which will only be used up over a considerable period of time. Where this is the case instead of charging all equipment as purchased in one account it is much better practice to have two accounts on the books, one for equipment in use, and the other to record new equipment in store. All equipment as purchased should be put into store and issues made as required. The cost of equipment as purchased is charged to "Equipment in Store" account and as issues are made the cost of the issued equipment will be credited to the "in Store" account and debited to "Equipment in Use" account. The inventory of the equipment in store at cost should agree with the balance of the "Equipment in Store" account at all times.

While equipment in store should be valued for inventory purposes at cost, due account of depreciation must be taken in pricing the inventory of equipment in use. Since the stock of china and glassware in use is being continually renewed to replace breakages, it does not depreciate to any great extent and it is usually sufficiently conservative if china and glassware is reduced to about seventy-five per cent. of cost over a period of about five years. Linen and silverware, however, are not being renewed to the same extent and it is usually necessary to write down their value to about fifty per cent. of cost over a period of three years. These estimates, given by J. O. Dahl in *Restaurant Management* and based upon experience in averages cases, are given as indications of what others have found and should not be followed blindly. The amount of linen in comparison to the number of covers served daily, the class of dining room and the laundry policy all have a bearing on the amount of depreciation which takes place in a given period and an examination of the condition of the articles is the best guide to their value.

It is not practical to take inventories of linen, glassware, china and silverware monthly and provision is made for depreciation in the monthly operating figures by setting up a reserve either on the basis of a percentage of the sales of the month or by charging a fixed amount for each meal served. The former method appears to be more generally used and since the volume of sales should bear some relation

to the number of dishes and pieces of silverware used it is probably more nearly accurate. At the end of the year the amount by which the opening inventory plus additions during the year exceeds the closing inventory, is transferred against the accumulated reserve and any difference adjusted through profit and loss account. Linen, glassware, china and silverware is shown on the balance sheet at the end of the financial year at the net figure as determined by the physical inventory.

According to some authorities depreciation may be as low as 1½% in cafeterias and restaurants using little linen and as high as 6% in high class restaurants and hotel dining rooms. For a first class restaurant not connected with a hotel 3½% of sales, divided 1½% china and glassware, 1½% linen and ½% silverware, is usually adequate. However, where there is insufficient information available to determine the percentage required inventories should be taken every two or three months and the reserve checked with the actual figures.

Useful Life of Equipment

Schedule in common use by a large number of hotels, as given by J. O. Dahl in "Restaurant Management:"

Ranges	15 years.
Ice Boxes	25 years.
Bake Shop Equipment	30 years.
Bake Ovens, Brick	40 years.
Stock Pots, Aluminum	30 years.
Stock Pots, Copper	25 years.
Coffee Urns	20 years.
Dish Washing Machines	10 years.
Dish Conveyors	31 years.
Bread Slicing Machines	10 years.
Electric Toasters	7 years.
Egg Boilers	10 years.

Miscellaneous kitchen equipment including pans, metal kitchen sinks, meat choppers etc. . . . average 30 years.
Composite life to cover all the above equipment . . 15 years.

Books of Reference

Cost Accounting - - - W. B. Lawrence
Hospital Accounts and Financial Control Joseph E. Stone
Restaurant Management - - J. O. Dahl

Description ....Size .... Max. ...... Min. ...... NO. .....

RECEIVED					ISSUED					BALANCE		
Date	Invoice	Quantity	Price	Value	Date	Req'n	Quantity	Price	Value	Quantity	Price	Value

Form No. 1—Perpetual Inventory Record

DAILY FOOD COST

Date

	Unit Price	Amount		Unit Price	Amount
Kitchen			*Pantry*		
Beef—Rib			Eggs		
Filet			Fruit		
Short loin			Cheese		
Lamb					
Pork					
			Bakeshop		
Vegetables			Milk		
Potatoes			Eggs		
			Flour		

Form No. 2—Distribution Sheet for Daily Food Cost

DAILY FOOD SALES

Date

Kitchen	Portions	Sales	Transfers	Net	Kitchen (cont'd)	Portions	Sales	Transfers	Net
Beef—Boiled					Potatoes				
Steak rump					Sweet				
					Baking				
Ham—Boiled					Vegetables				
Smoked					Carrots				
					Cauliflower				
Pork—Loin					Peas—Fresh				
Shoulder					Canned				
					Beans—String				
					Dried				
					Canned				

Form No. 3—Distribution Sheet for Daily Food Sales

COMMISSARY OPERATIONS

Date

	Day		Total to Date			Day		Total to Date	
	Cost	Sales	Cost	Sales		Cost	Sales	Cost	Sales
Kitchen					*Pantry*				
Pastry Dept.					*Summaries*				
					Kitchen				
					Pantry				
					Pastry Dept.				
					Fountain				
					Covers served				
					Table d'hote				
					A la carte				

Form No. 4—Daily Summary of Commissary Operations

Practical Auditing - - Spicer & Pegler
Auditing Theory and Practice - Montgomery
Accountants' Handbook—Section 27, Second Edition
Hospital Accounting—Departmental Analysis.
K. E. Greenwood, C.A., The Canadian Chartered Accountant
The Problems of Hospital Management A. E. Sawyer
A Uniform Accounting System for General Hospitals.
Commonwealth of Pennsylvania, Department of Welfare
Institutional Food Conservation - United States Food Administration.
Sound Accounting Systems Essential for Restaurants
A. S. Tindale, C.A., Canadian Hotel Management & Restaurant News.

THE SOVIET FINANCIAL SYSTEM

By D. C. MacGregor, Toronto

IN the last twenty-three years Russia has undergone an unprecedented range of financial experience. Before the first revolution which took place in February 1917, the public treasury had been forced into inflation by the combined effects of heavy war expenditures, the absence of a modern taxing system and inability to float large bond issues. To the chaos of currency inflation the revolution added the gradual confiscation of factories and other private property, operation of factories by workers' committees and disappearance of the banking system and systematic accounting. During the period of war communism from 1918 to 1921, which coincided with the civil war in many parts of the country, all available supplies of food and materials were requisitioned by the government and rationed out to the populace without the use of money while barter largely replaced money in miscellaneous local transactions. Foreign trade ceased. Along with the disorganization of production, the money economy had practically disappeared, and with it all vestiges of financial records and controls.

Economic and financial reconstruction began with the New Economic Policy (N. E. P.) of 1921. The State Bank or Gosbank was established in October of that year. It confined itself to financing light industry, largely out of

budgetary grants. Meanwhile, large issues of paper money continued to pour from the treasury until the summer of 1922 when a new and stable monetary unit, the chervonetz, was introduced. Once the currency had been stabilized, the restoration of a sector of private enterprise (chiefly agriculture and merchandising) and the more systematic operation of government undertakings called for financial assistance and supervision. A number of additional institutions known as banks were set up to finance foreign trade, co-operatives and the electrical industry. Capital was necessarily supplied by the government, and these banks might better be described as divisions of the department of finance established to supervise capital investments. Meanwhile the system of requisitioning government supplies and confiscating private and church property in lieu of taxation was being replaced by a systematic taxing system. Thus the monetary, fiscal, financial and accounting systems which had been destroyed in the upheaval began to be reconstructed on the basis of a much larger sector of public ownership than hitherto, large scale industry being almost wholly state-owned.

The use of money and credit, of taxes and the systematic discipline of accounting, were thus found essential to the orderly conduct of state capitalism, but the new system necessarily differed from the old. With the disappearance of all large private incomes and hence of most private savings, it was no longer possible to secure capital funds by selling securities, nor to impose progressive income and inheritance taxes in the hope of securing a large public revenue. There was no longer a money market or a stock market, a single great capitalist, the state, having replaced all the large private capitalists.

Although many of the significant features of the system now in use began in 1921 with the N. E. P., the system of the early 1920's and indeed up till the commencement of the first Five Year Plan did not differ as greatly from that in other countries as might be supposed. State enterprises bought their materials and sold their products in more or less competitive markets and no serious attempt was made to unify the activities of various government departments and factories. Moreover, the construction ot new capital equipment was neglected by the government

except in a few branches such as electric power, the state not yet having adequately replaced former private savers as a source of investment funds.

The system of centralized planning and control which first swung into action in 1929 differed from its predecessor the N. E. P. in two respects. First, elaborate and highly systematic methods of raising and segregating funds for new investments were introduced. Second, the more or less competitive determination of prices of raw materials and finished goods, and the operation of individual plants as more or less independent enterprises was replaced by a system of controlled prices and integrated operations.

The Budget

The character of the financial system at large may be most readily grasped by a study of the union or federal budget. The following table[1] presents the essential features of the estimates for the calendar year 1934, reclassified under the terminology familiar in other countries (in millions of Roubles).

TABLE I

Revenue		
Indirect taxation: sale and excise tax (of which about 1/3 is derived from the sales tax on bread, largely at the expense of farmers who are paid a very low price for grain)		36,823
Direct taxation of individuals: chiefly income and inheritance taxes		3,032
State enterprise: chiefly transport (gross receipts)		4,458
State borrowing: from the public and from financial institutions		4,325
Sundries		781
		48,879
Expenditure		
Administration:		
Government	1,078	
Defense	1,795	
Education[2]	2,669	
Health[2]	238	
Insurance	268	
		6,048
State enterprise (almost wholly new investment) of which expenditure for industry was 15,595, agricul-		

[1]From Hubbard, as cited below, p. 113.

[2]Does not represent the total expenditure for these purposes, much of which is made by state and local governments and industrial establishments.

ture 5,880, transport 5,594, communications 302, trade 3,921, reserve funds 1,300, other 791		33,383
Loan Service		
State loan	1,702	
Repayment of debt to State bank	1,000	
		2,702
Grants to state and local governments		3,698
Sundry funds		1,477
Surplus (to reserve)		1,571
		48,879

For the purposes of this discussion, certain items are of outstanding importance. On the revenue side, the bulk of the income is derived from commodity taxes, the rate of the sales tax varying from 5% to 80%. On the expenditure side, the bulk of the outlay is for new investment in factories, agriculture, transport and trade. This has been almost entirely paid for out of current revenue. In addition to the union or federal budget, estimated expenditures of the states were R.2,700 million and of municipalities were R.7,700 million.

The public debt, transactions relating to which are of small importance on both sides of the table, is of more interest than its size would indicate. At first sight, one would imagine that public borrowing would be unnecessary since the State, as the sole capitalist and the sole monopolist, can secure money from taxation, operation of industry at a profit, and through control of the currency and the banking system. In practice these devices have not always yielded adequate revenues, at any rate as they have hitherto been administered, with the result that public borrowing began as early as 1922[3]. The first loans were practically compulsory, and for the most part yielded high rates of interest. As shown in columns IV and V of table II, most of the debt has been contracted since the beginning of the five-year-plans. As will appear below, the existence of a certain amount of public debt simplifies administration of assets of the banking system, which is the chief creditor, while the creation of debt may at times be utilized for promoting savings and offsetting an inflationary tendency without reducing wages.

[3]A valuable survey of credit operations will be found in G. Y. Sokolnikov, et al., *Soviet Policy in Public Finance*. Stanford University Press, 1931.

The growth of revenues, expenditures and debt is summarized in the following figures which though not wholly comparable throughout serve to show the main tendencies.

TABLE II

	I	II	III	IV	V
	(in millions of Roubles)				
	Total union or federal budget revenue.	Investments in state enterprises.	Cost of defence and administration.	New loans floated.	Internal national debt outstanding.
1925-26	4,216	563	1,078	230	417
1928-29	8,428	4,784	1,207	725	1,422
1929-30	12,986	7,681	1,397	1,278	2,595
1931	23,861	18,048	1,714	3,269	2,934
1932	31,629	23,664	1,987	3,922	6,221
1933	35,010	23,912	2,264	4,012	10,080
1934	48,879	33,384	2,873	4,325	14,369
1935	65,900	35,157	9,039	4,415	16,969
1936	78,715	37,583	17,897	5,150	19,418
1937	98,069	39,586	24,570	5,975	22,814

Source: *The Economist*, London, March 27, 1937. p. 705. Figures for 1925-6 are from Sokolnikov, op. cit., pp. 312, 319, 266 and 270.

This table is an accountant's and economist's thumbnail sketch of the course of Russian development. While defective in that it ignores changes in the quantity and effectiveness of capital equipment created by the outlays entered in column II, a reasonably accurate picture of the growth of investment is nevertheless presented, indicating the enormous reorganization of the economy brought about by the first five-year-plan. The recent concentration on defence is also noteworthy while a detailed presentation would show a striking expansion in the outlay for social and cultural purposes in 1937.

The enormous increases in column I, especially prior to 1932, reflect not only the expansion of national production but also the increasing socialization of the economy and a measure of currency inflation during the first five-year plan.

It should be noted that neither the gross nor the net receipts of industry at large (transportation excepted) are taken into the budget. Only tax payments based on sales, profits, etc., are included.

The Gosbank—With this general background we may now concentrate upon the banking mechanism by which the currency is controlled and the short and long term

capital needs of industry are provided. The state bank or Gosbank closely resembles the central banks of other countries in that it is the sole bank of issue and the depository of cash reserves of other banks. Transactions with foreign countries are handled by the Bank for Foreign Trade which is virtually a department of the Gosbank. The Moscow or central office of the Gosbank acts as a clearing house for all banks in the country. There are 42 regional offices and about 2,400 branch offices and agencies.[4]

Short-term credits granted by the Gosbank for the financing of current production and distribution are an important part of the technique of planning. Each establishment is granted a quarterly quota of credit and the rate at which this is drawn against and replenished by current income is carefully scrutinized. Separate accounts are kept for the payroll, which is drawn out in cash, and other main items of expenditure, enabling the bank to make what is virtually a rough audit of operations from its own records. For seasonal or occasional operations such as payment to growers of industrial crops or large construction works the bank may open a temporary branch and handle disbursements or payroll itself. Thus financial supervision is omnipresent and exacting, so much so that "it may be questioned whether the system that has evolved is not too rigid. Cases are not infrequently quoted in the Soviet press in which the alleged bureaucratic and uncompromising standpoint of local branch banks in dealing with emergencies has inflicted hardships on perfectly well managed enterprises." Stories are told of perishable goods being allowed to rot in the freight sheds because of the failure of recipients to meet drafts promptly.

Interest is charged on short term credits at six per cent. per annum. The routine of granting and repaying such credits and of making collections is not sufficiently different to merit emphasis in this short outline, other than to remark that as in the case of long term accommodation the technique employed places great responsibilities on the banks.

The Industrial Banks—Around the Gosbank and the Commissariat of Finance are grouped a number of indus-

[4]For most of the information on the banking system the writer is indebted to L. E. Hubbard, whose recent volume *Soviet Money and Finance* (MacMillan, London, 1936) is almost the only authoritative treatment written in English.

trial banks occupying a strategic position which enables them to exercise more power than comparable banks in other countries. These industrial banks, which have undergone considerable reorganization since they were first created in 1922, are now four in number: the Prombank, the Communal Bank, the Co-operative Bank, and the Agricultural Bank.

The *Prombank,* largest and most important of the industrial banks, concentrates and disburses funds allocated by the central planning authority for the capital requirements of industry at large. While the bulk of its receipts are from capital appropriations in the budget, it also derives its funds from more or less statutory payments entrusted to it (nominally as deposits) out of the industrial profits and amortisation reserves of industry. Only a small proportion of the bank deposits of industrial undertakings are allowed to remain under their own control, the necessity of borrowing for working capital requirements being forced upon them in order to bring them under close financial supervision. A fraction of the deposits is left in the hands of the trusts or combines, which control the operation of individual plants.

Capital outlays of a less remunerative character corresponding roughly to public works, as that term is used in Canada, are under the supervision of the *Communal Bank.* In the hands of this organization are concentrated budgetary grants, the yields of certain local taxes on public utilities, part of the revenue of social insurance schemes and a proportion of the funds set aside by industrial establishments for improvement of living conditions. Some of the receipts are credited to special accounts but most of them are pooled to form a large fund for the erection of houses, schools and hospitals. Thus the Communal Bank serves many of the functions of an ordinary municipal or provincial treasury but it operates largely on a pay-as-you-go basis and has many sources of revenue. Advances which are made from funds having the character of deposits rather than grants or taxes are loaned at interest with maturities of from twenty to sixty years. The Communal Bank, like the Prombank, exercises important functions of audit and supervision over those to whom it has advanced money, combining the functions of mortgage company, public treasury and outside auditor.

The *Co-operative Bank* provides similar facilities for co-operative undertakings other than dwelling houses and farms. Its capital is subscribed by co-operatives themselves. Deposits consist of the proceeds from levies on the net profits of existing co-operative undertakings, which like taxes are non-reclaimable, and of reclaimable deposits made by the same bodies together with small government grants. Most of the bank's advances are repayable interest-bearing loans, the receipts from which replenish the investment fund. This bank may be regarded as a centralized department for promoting and administering corporate saving and inter-corporate lending within the co-operative sector of the economy.

There is also an *Agricultural Bank* which finances the collective and state farms. Its liabilities resemble those of an ordinary capitalist bank in that they consist chiefly of reclaimable deposits at interest. These deposits are matched by interest-bearing maturing loans, extended to farm organizations, the rate of interest on which is supposed to be increased by 50% if they are not paid off at maturity. From government grants the bank also makes non-repayable advances. Like the parallel organizations for other industries, this bank discharges important functions of supervision and audit.

The number of branches of these four industrial banks is not large. In many cases current transactions and book-keeping are handled by the local branch of the Gosbank, the duties of supervision and audit on a new undertaking not usually requiring establishment of a permanent branch. Thus the Gosbank provides, in addition to the facilities of a central bank and clearing house, a strong framework of routine branch banking for short term accommodation upon which is erected the superstructure of specialized banks devoted to the amassing and distributing of primarily long-term funds.

An important phase of the work of all industrial banks which finds no parallel in banking institutions elsewhere but is instead handled by the public treasury, if at all, is the making of grants for long-term investment against which amortisation within the estimated life of the asset is charged, but no interest. This type of operation is made possible by the fact that the income of the banks consists

largely of annual appropriations entrusted to them by the treasury for disbursement and not likely to be recalled. Thus in their long-term operations they resemble the farm loan department of a capitalist government rather than an ordinary bank. They are not in themselves run for profit.

Savings Bank—The savings bank is in many ways the most familiar type of organization. It has about 60,000 branches, many of which are in post offices. It is the only institution which receives the deposits of individuals. Like certain government savings banks in Canada it invests its assets wholly in state bond issues, which to some extent exist for this purpose. At the end of 1935 interest was being paid to depositors at 8% per annum but the rate has since been lowered. Checking facilities are provided.

The existence of savings banks along with government bond issues and both compulsory and voluntary insurance schemes indicates an extension of the institution of private property, hitherto confined largely to personal belongings and the limited amount of land, live stock and housing granted to the peasants. As a result of these changes one might expect the growth of private fortunes in Russia, and a gradual return to a greater inequality in the distribution of wealth.[5] Important and probably decisive checks upon the growth of inequality are the impossibility of conducting private enterprise on anything but the smallest scale, the inheritance tax and the difficulty of transferring Russian funds into foreign currency. The rates on inheritance tax are steeply progressive and reach 100% on all assets over a moderate sum. The writer has no information on the possibilities of tax evasion but it is self-evident that the conspicuous possession of wealth in a country where fortunes and speculation are prohibited would soon come to public attention, just as the purchase of a mansion by a bank clerk would in Canada. Prior to the collectivization of agriculture serious difficulties were encountered in dealing with the distribution of income among the peasants. Within a decade after the distribution of land, substantial inequalities arose which the progressive income tax (which can hardly

[5]The spread between the highest and lowest yearly incomes of Russian workers of given age is small, being roughly proportional to the spread existing in the civil service and the universities of Canada, the highest income being from twelve to fifteen times the lowest. Men and women are given equal pay for equal work.

ever be applied successfully to small farmers) was powerless to offset because of evasion. Indeed, it was in large part the failure of the income tax to check the rise of the better-to-do farmer or kulak which led to forced collectivization. No comparable problem of growing inequality among wage earners has become apparent, although social stratification resembling the distinction between white collar and manual workers has appeared, while select groups of high officials and artistic workers have been noted by some observers.

In their control of individual establishments, the banks and central planning organization must face the problem of what to do with badly located or antiquated industrial plants. Under private capitalism such equipment usually goes out of operation because of deficits, unless it is the beneficiary of a direct government subsidy or tariff protection or is controlled by a large organization (e.g., a public utility) which can use the profits from some operations as a concealed subsidy to offset the losses of others. In Russia, the need for capital equipment is so great that little or none of it is discarded, though buildings and land are frequently diverted from one use to another. The system of price fixing and the cost of supporting a universal system of factory welfare schemes necessarily results in deficits or at any rate inability to make corporate savings, in certain industries. Subsidies and the equivalent of interdepartmental or interregional transfers must therefore be used even more widely than under private capitalism but on balance the gross receipts from all current sources exceed current or ordinary expenditure by a wide margin which is devoted to capital investments, along with any new emissions of currency and credit which may be made.

An important but unmeasurable form of assistance to industry arises out of the deliberate isolation of the Russian economy from foreign competition. Imports are controlled by an import monopoly which buys abroad only those things which are considered worth while from the standpoint of the long-term objectives of planning. Moreover, the import monopoly does not necessarily sell foreign goods at cost and in no case will the selling prices be such as to conflict with the established internal price structure. A profit in roubles on resale of imports may incidentally be used to offset a loss

in roubles on sales of exports.[6] This method of handling foreign trade may be used, in conjunction with the financial control of industry at large, to spread the losses from a decline in exports evenly over the whole economy, thereby avoiding the type of dislocation frequently encountered in Canada. The incomes of workers in Russian export trades do not appear to have suffered in the depression.

It need hardly be pointed out that the purchasing power of the Russian internal currency has, at any rate until recently, borne little or no relation to the cost of the rouble in foreign money.[7] It has therefore been quite impossible for the government to make a decision as to the relative economy of domestic production vs. imports by comparing Russian and foreign prices and costs at the official rate of exchange. Nor can any other than the official rate of exchange enable such comparison owing to the peculiarities of the Russian price structure arising from the policy of price fixing and taxation.

Price Control and Capital Accumulation—The control of prices, wages, and credit which has been in force since the introduction of the first five-year-plan is of strategic importance along with the commodity taxes. Primary producers, especially grain growers, are paid a very low fixed price for their grain partly in lieu of land and other taxes, while the selling price of bread is high as a result of a heavy sales tax, the spread representing the state's profit. But while the tax on bread yields a large revenue, many other prices are fixed to cover no more, or even less, than operating costs.

As a rule prices are fixed irrespective of changes in the supply and demand situation. If demand is keen and prices low, supplies become exhausted without an advance of prices or profits and no additional output materializes. The plan, not price and profit, is the regulator.

All this seems rather clumsy, and it is so, but there is good reason for it as long as Russia is forcing the pace of capital creation and the upbuilding of her defences. It

[6]This is equivalent to paying an export subsidy with the proceeds of a revenue tariff.

[7]A similar situation now exists in Germany, but more because of the varying prices at which the mark is sold to different buyers than because of price discrimination within the country.

must be remembered that unlike other countries practically all of Russia's employable labour and capital is working full time or overtime. More bicycles and cotton clothes mean fewer railways, tractors and airplanes. The output and sales of consumption goods must be restrained either by rationing or by raising their prices relative to wages. As rationing has largely been discarded, prices of consumers' goods must be kept up to such a point, by price fixing and taxation (which is really another form of price fixing), that the aggregate value of all the goods and services and housing which the planning authorities see fit to produce can just be purchased by the aggregate income paid out to the whole population.[8] The difference between the aggregate sales to consumers and the aggregate current money cost of producing all the things consumers buy represents the state's profit (roughly equivalent to capitalist exploitation)[9] and the allowance for depreciation. This profit, much of which appears as tax revenue, is the principal fund available for the creation of capital goods.

If, when capital and labour are fully employed, it is desired to create still more capital goods without encountering the dislocations of an inflation, five methods are available: (a) increase the efficiency of the capital goods industries without paying out additional money, or (b) increase the efficiency of the consumers' goods industries without paying out additional money or expanding total output thereby enabling the release of workers, equipment and materials for the extension of capital goods industries, or

[8]This deserves some qualification if consumers are placing a part of their income in savings banks, insurance or private hoards. The greater the amount of such withheld purchasing power, which is as it were temporarily frozen as far as consumers' goods are concerned, the more prices can be lowered and the less predictable the demand for such goods becomes.

[9]The principal differences between socialist and capitalist exploitation appear to be (a) that under socialism none of the profit is used for the purchases of luxuries by a leisure class, the whole of it being ploughed back into new investment and welfare expenditure, (b) that the profit is reinvested as fast as it is made, thus preventing instability in the construction industries which is an important factor in capitalist depressions, and (c) that since the profit is collectively owned and does not give rise to inequalities of income and resultant jealousy, the workers are willing to submit to a more burdensome exploitation to provide profits and taxes in the knowledge that what they give up today through the high cost of living will be returned to them and their children in the future in the form of either a lower cost of living or more amenities.

(c) raise the price of consumers' goods by price fixing, taxation or inflation, without raising wages, in order to lower the real purchasing power of the population, increase the state's profit and permit a reduction of output for consumers. Methods (b) and (c) enable a diversion of productive factors to the making of capital goods. Or again, (d) reduce wage rates and prices paid to primary producers which is an alternative method of increasing the state's profit and enabling the same adjustment as in (b) and (c), and finally (e) secure a larger amount of saving among the populace by a larger net inflow of savings deposits or larger net purchases of government bonds. Along with rationing, the alternatives here described bear a close resemblance to the methods by which resources must be mobilized by any economy in preparation for a war. Difficulties may be encountered in moving the labour force but the reservoir of untrained peasant labour, eager to go to the cities, can be drawn upon in emergencies.

Ability to Control Inflation—The inflationary potentialities of the Russian system became evident during the first years of the five-year-plan. Additional short-term credits were created for enterprise by the Gosbank, necessarily in advance of the outturn of consumable goods, which led to larger wage payments and a more urgent demand. But the anticipated outturn of goods did not materialize. Fixed prices were not raised, though shortages in the shops became acute. As a result, purchasing power was naturally diverted to the relatively small supply of goods sold competitively in the free peasant markets and in the commercial stores,[10] with the result that prices in that sector rose abruptly. It should be noted that inflation did not disturb the relative fortunes of various groups nearly as much as under private capitalism.

Three methods of checking the progress of inflation, without slackening the pace of capital expenditure, were available. First, a widespread but relatively small increase of fixed prices in all types of shops which would have had the effect of raising the cost of living generally, increasing the state's profit (garnered by taxes on sales and profits

[10]Strictly speaking, prices in the commercial shops were fixed prices, but they were moved up and down in accordance with supply and demand and were another device for absorbing an excess of currency. Prices in co-operative and factory shops were held at a constant level.

and by business deposits in the industrial banks) and enabling a smaller expansion of bank credit and note issue (method *c*, above). Second, a reduction of wage rates and prices paid by the state for farm products which would have reduced the excessive disbursement of purchasing power immediately (method *d*, above). Third, a sidetracking of excessive disbursements into the hands of the state by securing from the public a large net inflow of deposits to the savings banks, or larger net purchases of government bonds (method *e*, above). Fourth, an increase in efficiency, or a reduction in the quality of products, of the existing capital and labour in the consumers' goods industries, resulting in larger output (insofar as available raw materials and transport permit) and a smaller tendency for prices to rise. In practice the third method and both aspects of the fourth were applied. During the course of the second five-year-plan the increased output of consumers' goods has reversed the upward movement of prices.

The Russian system has important technical advantages. As a result of the close integration of financial institutions, funds for capital creation may be and in fact usually are disbursed at exactly the rate at which they become available, in marked contrast to our own system, thus maintaining the construction industries at a constant level of activity and perpetuating the level of employment and the rate of flow of consumers' incomes (i.e. purchasing power). Thus the Soviet economy is freed from the disastrous disturbances to confidence and to values which play a large part in causing and prolonging capitalist depressions. The creation of contractual debts is limited in amount and while unforseen failure of enterprises to discharge their obligations with respect to either money payments or output may create serious monetary problems, these are more likely to bring on an inflation than a depression and can in any case be offset by appropriate monetary action before they have gone very far. In addition, the Russian economy is to a large extent insulated from disturbances to prices and finance abroad.

The ability of the Russian financial system, operating upon the rich resources under its control, to carry out enormous undertakings comparable to the scale and rapidity of modern warfare may yet prove of fundamental import-

ance since Russia can probably finance a war with less dislocation of prices (especially in the aftermath) than any existing systems of private capitalism[11] with the possible exceptions of Germany and Japan. It has been argued by historians that the feudal system, whose existence was largely dependent upon the effectiveness of small private armies, fell largely as a result of the invention of gunpowder and heavy cannon which revolutionized warfare, whatever that system's merits may have been in other directions. It is worth while enquiring whether, as a result of weaknesses in its financial and pricing system, private capitalism (irrespective of its other merits) may not meet a similar fate at the hands of regimented systems more capable of withstanding the financial strains of warfare and forced development without giving way to the chaos of violent inflation, deflation and unemployment.

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[11]The present Russian government, like that of Germany, has benefitted from the extinction of pre-war internal debt and the repudiation of foreign obligations. But neither of these countries can continue to increase internal debt at the present pace indefinitely unless they are prepared (and presumably they are) to reduce the interest charges. In the case of Russia, continued borrowing may be expedient but it is not essential.

SOME SUGGESTED REFORMS TO THE DOMINION COMPANIES ACT

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WHEN considering legislation for a country, it is well to remember that, as a rule, a people get the laws which they deserve, and also that it is impossible to legislate a nation completely into paths of righteousness. On the other hand, many peoples, including the Canadian, are doing their best to deserve better laws, and the legislation of a nation should be, at least, an expression of the just character and ideals of that nation, and also should be applied with due strictness and impartiality. Accordingly, we in Canada must make our laws as good, as reasonable and as strong as we can, making it as difficult and as dangerous as possible to do wrong, but remembering that they must not impede unfairly the good acts of well-intentioned members of the community. Our civilization is dependent for its very existence on commerce, and a high standard of commercial morality, one of the greatest essentials for a flourishing commerce, requires corresponding laws. Conditions are continually changing with time, and accordingly those laws, under which our commerce and industry are carried on, must come under constant revision in order that they may properly carry out the control and functions required of them. The greater part of the trade of this country is carried on by means of incorporated companies, and the Dominion Companies Act, which regulates their formation, life and death, must be examined continually, so that it may be kept up to date, that it may deal with current problems, and that it may be as sound and as effective as is possible. This is of especial importance where this Act deals with the statements to be issued to shareholders, and to bondholders and other creditors, because most important and far-reaching decisions have to be made on the information contained in those statements. They must be made so informative and so reliable that those, who have to make these decisions, may be able to depend on them.

A Company's Capital

The foundation of every company consists, or should consist of the capital contributed by the shareholders. The original idea was that this should be in the form of cash. Later, valuable assets were taken instead of cash, on the perfectly just grounds that the company needed them to start its business, and that if cash were contributed instead, it would have to buy them with that cash. Nowadays, all kinds of consideration are taken for shares, including "services rendered," goodwill and other intangible assets. In many cases, the value of such consideration has been a moot point and, in some cases, it has been questioned whether this consideration has ever been in existence at all. To deal with this, section 12 (9) of the Act, as amended by section 5 of the 1935 Act, provides for the directors making an express resolution as to consideration other than cash, which is accepted for shares in their company, "having a nominal or par value." They must "determine by express resolution" this property or these services "to be in all circumstances of the transaction the fair equivalent of cash to the total amount of the shares issued." If they wish, the directors may obtain a ruling or "declaratory order" from a judge as to the fair value of this consideration, and the judge may require whatever evidence he thinks fit. This ruling, once given, is to be taken as final and conclusive proof in all courts as to the value of the property or services rendered. This is all to the good, because, if any board of directors has not obtained a ruling and in a subsequent enquiry the value of this consideration is questioned, quite naturally there will be raised the question, "Why did you not obtain a declaratory order from a judge at the time as to the value of this property?" It is suggested that this ruling be strengthened by providing that, where no declaratory order has been obtained regarding the value of "services," there should be required in the minute recording the directors' resolution sufficient details to show the nature of the services rendered and as to how and why they were of value to the company. It should apply to all kinds of shares issued for "services rendered." The details should include dates, places, brief descriptions of the services and so on. If the details are too voluminous, there could be a reference in the minutes to the document containing them, and the document could be filed

with others which deal with the foundation of the company. This requirement is going to cause difficulty in cases, where the services consisted in, say, arranging with the council of a certain town or city by means of suitable "gratifications" that they would vote a certain concession to the company. That, however, could not be helped. Every shareholder, who has contributed cash or tangible assets, is entitled to know that there is a permanent record giving an idea as to the services rendered by someone who was allotted therefor shares similar to his own, with the same rights of sharing in profits. For this reason it is suggested that section 12(9), as amended, should also apply to shares of no par value.

This provision is intended to be supplemental to what is necessary in order to comply with requirements such as those of section (77) (1) (*q*), (company prospectus to contain particulars of services rendered, as far back as two years, being paid for by its securities); Sec. 112 (2) (*k*) (balance sheet to contain details of shares issued since last balance sheet for services rendered); Sec. 121 (1) (*h*) (annual return to give amount of shares issued for services rendered).

Some of us will remember an enquiry into the affairs of a company, in which a person had been allotted shares in return for "services rendered," and, when he was asked what they consisted of, he could not remember. A written record provides documentary evidence, and is always a certain check on men who have unfortunate (or fortunate) memories, because there are some men, who will not hesitate to utter a lie by word of mouth, but who will quite refuse to write an incriminating lie in a document, which may become evidence. It is a matter of human nature, and self-preservation is one of humanity's strongest instincts.

Of course, there is the danger that, when the record is going to be awkward because of an impending enquiry, it may be "lost," a small fine being perhaps paid by a luckless secretary for his delinquency. This could be guarded against by ordering the filing of such a record with the secretary of state at Ottawa, neglect to do so being made a criminal offence.

Goodwill

The same procedure should be followed for any asset accepted in lieu of cash. There should be a permanent

record as to how its value was determined. If the figure was obtained by simply "thinking of a number" then only that could be stated, but it would carry with it, very naturally, certain implications that the true value was not searched for with great assiduity. Valuation can be obtained for most assets. This applies especially to that much-abused asset goodwill. Now this asset has a very real existence, and has been recognized in the English courts for centuries. The oldest known decision concerned a shop in Newport, Isle of Wight, and occurred in 1620. It had to do with "the selling of custom and leaving another to gain it." Since the beginning of the last century the underlying ideas of goodwill have been more and more clearly set forth by different judges and writers of high repute. Probably the simplest and best statement regarding goodwill is one of the latest, that of Professor Dicksee, who wrote "when a man pays for goodwill he pays for something which places him in the position of being able to earn more money than he would be able to do by his own unaided efforts."

Now, in essence, goodwill is a power to earn extra profits, and that power should be valued, so far as it is possible to value anything intangible in this world. All assets should be valued in the bright light of past experience and the rather dim and uncertain illumination of future probabilities. In the valuation of goodwill certain figures are taken from the past, those that show that extra profits were actually earned, and others have to be estimated for the future by a fair arbitrator. There are approved methods of using these figures, and their intention is to place a fair value on this power to earn extra profits. If the goodwill of some public companies had been properly valued before being purchased by them and brought into their books, the resultant figures would have been much smaller than the present ones and might have disappeared altogether; because enquiry would have shown that the vendor concerns had never earned more than normal profits, and had no prospect of ever doing any better. If examination over a period shows that a concern earned no profits over and above the ordinary profits, then there is no goodwill at all in existence. Of course, we are all familiar with those professional optimists who tell of the wonderful things they are going to do with badly-paying concerns, and how, after they have finished re-organizing, economizing and develop-

ing, immense profits will be earned. We know how they would have us to believe that this future power to earn extra profits, this "potential goodwill," is worth paying a big price for, but we also know how often they exaggerate. We know that they simply hope to earn extra profits, and they wish to capitalize this hope of theirs, getting us to pay for it. The fact is that valuators seldom (or never) have the gifts of clairvoyance and prevision, and, if there are no extra profits in the past, they cannot say that there probably will be in the future. The writer knows of a case of a single trader who, commencing a store for the first time, had himself incorporated, and the principal, almost the only asset by which he paid for the capital stock in his own company, was some entirely imaginary "goodwill." He certainly never earned even normal profits before he was incorporated, because he was never in business; nor has he earned more than normal profits since. Various small, trustful and ignorant dealers, probably impressed by the fact that they were selling goods to an incorporated company, gave him credit and he cheerfully commenced to carry on business with his creditors' money, quite proud of the fact that he was president of an incorporated company. The reader can estimate for himself the creditors' chances of repayment in the event of an insolvency. The same thing has been done on a large scale by larger concerns, and it is a vital matter for the sound finance of this country that this kind of thing should, if possible, be stopped, or at least be made difficult and dangerous. We all know of cases of individuals who, under different guises, have lived for quite a long time and in more than ordinary luxury on the proceeds of goods sold to them by trustful creditors. A case in point is that of a wholesaler, generally regarded as a "wonderfully clever business man," who for years obtained a quick turn-over by selling merchandise at a little less than cost. Of course, in the end his mounting liabilities "got" him—but they "got" his poor creditors as well. The amount of impudence that some concerns display in valuing their goodwill at times takes one's breath away; but at present there is no check: in their opinion it is worth $1,000,000 and should be sold at that price to an incorporated company, whilst in an outsider's opinion that goodwill is worth absolutely nothing. If the purchasing company, being run by friends

of those who are running the vendor company, also thinks that the goodwill is worth $1,000,000 then the outsider's opinion will not count for much, as between the companies.

The consequent suggestion is that it should be made illegal to bring goodwill on to the books of an incorporated company, unless there has been filed at Ottawa a full statement, signed by valuators, showing how its value has been computed, and having attached thereto all necessary supporting financial and other statements, duly audited. A certified copy of this statement with its accompanying documents should be kept with the company's permanent records. It should be illegal for the purchase of goodwill by a company to be complete, until it has obtained such statements. Then, if the valuators have used the "Let us think of a number" process of evaluation they will have to state the fact, or tell a number of lies; and as pointed out above, there are some who will hesitate a long time before they will state an elaborate untruth in writing, having it supported by false statements, when they know that all of it may be used as evidence against them.

Of course some will say that if the fraudulent over-valuation of goodwill is checked, dishonest people will simply turn to the over-valuation of some other form of asset. This is true enough, but, as a rule, the values put on other assets such as land and buildings can be checked by other values. Again, if they turn to franchises or patent rights, these should be valued at cost, like any other fixed asset, and if they are to be sold, they should be valued on a profit-earning basis, just as goodwill is valued. As a rule, it will be necessary to consider goodwill, patents, franchises and similar assets in one group, when arriving at their valuation, because when fixing the sale price of a patent one thinks not only of its cost and its unexpired period, but also of its power to earn extra profits. The difficulties of scientific valuations are not insuperable, and we ought to have permanent records as to how these values were obtained. If estimation has to enter in unavoidably, let that fact be stated. Gross over-estimates have often occurred in cases where there was evidence easily available from which proper valuations could have been made.

All of the above is supplemental to the requirements of Section 77 regarding the prospectus, and that section

could be very well amended so as to require the inclusion of these methods of valuation for goodwill and other assets. Prospective shareholders should know how the figure to be paid for goodwill was obtained, when the money is to come out of their pockets.

"Goodwill" in Consolidated Balance Sheet

We know how this much-abused term goodwill is used by some when consolidating the balance sheets of a holding company and its subsidiaries. There are many cases, where a holding company has transferred shares of its own to the shareholders of a subsidiary, of a much greater nominal value than the value of the net worth of the subsidiary, as stated in its balance sheet, because the net worth of the subsidiary was worth more than that figure to the holding company. If shares of no-par-value are used by the holding company this resultant difficulty can be avoided by fixing their nominal consideration at a convenient figure; but, if not, there arises the question of how the investment account in the holding company's balance sheet is to be eliminated against the net worth of the subsidiary, so that only assets, liabilities to the outside world, and the holding company's net worth may remain. Obviously the consolidated balance sheet will be short of value on the assets side, and under the Dominion Act it is illegal to issue shares at a discount. The proper thing to do is to re-value the assets of the subsidiary, so that they may be stated at their true value to the holding-company, which is on the whole higher than the subsidiary's valuation. It may be very difficult to do this, and possibly some take the easy course of simply adding an amount to the subsidiary's goodwill, without making any proper enquiry as to whether that asset really explains the price paid or not. The writer submits that this should be made illegal, and that, if it has not been possible to ascertain where the subsidiary's valuations should be increased, the item should be stated separately in the consolidated balance sheet under some heading such as "Value not stated in subsidiaries' balance sheets."

When shares are paid for in cash, it is of great importance to those interested in the sound financing of the company to know that the consideration has been dealt with properly, that is to say, in a manner which will best enable the company to meet its obligations, to carry out

its regular operations, and not to give a false impression as to its financial status. As the reader knows, the capital to be contributed for shares of no-par-value can be changed from time to time. They may be issued originally for $5.00 per share, and then, a few months later, shares of exactly the same class may be issued for $20 per share, and all of that class will have an equal equity in the net assets of the company. That equity will be made up of contributed capital, plus surplus, or minus deficit.

Distributable Surplus

Under Section 12, subsection 7 of the Dominion Act it is permitted to set aside 25% of the money contributed "as distributable surplus," the remaining 75% being credited to capital. Now this is just the same thing as issuing shares at a premium, because a company is earning large profits. It is only fair that new shareholders, who are going to share in those large profits and accordingly receive large dividends, should pay something extra into the company, because the original shareholders took more risk or had more knowledge than they had. Under these circumstances no one could reasonably object to the issue of no-par-value shares with the condition that a portion of the consideration should be credited to "a distributable surplus," provided that the amount was just and fair. Again, if a new company is taking over another as a going concern at the close of a financial period, and dividends for that period are due but have not been paid to the shareholders of the old concern, one can see how it would be reasonable to issue shares of the new company for a consideration, a portion of which, equal to the earned surplus in the old, is to be "set aside as a distributable surplus." If this is not done, the whole of the net assets of the old company, no matter whether they were there as a result of capital contributed to the old company, or profits earned by it, form the consideration for the shares issued, and cannot legally be distributed as dividend to the shareholders of the new company. Under these last circumstances a dividend paid by the old company to the new company is a return of a portion of the consideration for the new company's shares. If the new company takes that dividend and re-distributes it to its shareholders, it has paid a dividend which impairs the capital, and for it the directors are jointly and severally

liable under Section 83, subsection 6. To repeat, where a new concern issues shares to take over a going concern immediately at the close of a financial period, where there are undistributed profits in the old concern, and where the new company is substantially a continuation of the old, it is quite justifiable to introduce the element of "distributable surplus" into the consideration for the new shares issued. By this means the persons, who did not receive their dividends for the period just closed, as shareholders of the old concern may receive them as shareholders of the new. It would be better to arrange this, as was done previously, and as is done under other jurisdictions, by distributing the profits before the transfer of the old concern to the new, altering the date of the transfer as is necessary; but there is no great objection to doing it by means of the element of "distributable surplus," provided, of course, that amounts are fairly and correctly calculated and all is done properly.

Unfortunately, however, there are new companies, which are not continuations of old concerns and which are commencing all operations absolutely for the first time, that include in their first capital issues no-par-value shares with a portion of the consideration to be credited to "distributable surplus." It is extremely difficult to imagine reasonable justification for this. It could not be because the company earns very large profits, because the company has only just come into existence, has carried on no operations whatsoever, and no concern can earn profits before it exists. Of course there are the professional optimists, who write up some companies' prospectuses, and might have a general gift of clairvoyance, since they profess to know so much about future profits; but the law does not recognize clairvoyance as a means of judging the profit-earning capacity of a company, and the value which these people put on the large profits, which they expect to be earned (or say they do), is simply an attempt to capitalize a "pious hope." In this case "extra large capacity to earn profits" cannot be cited as justification.

Some say that it is a convenience to have in the books a credit, against which abortive capital expenditure can be written, so avoiding all necessity of replacing it out of revenue, and, accordingly of interfering with dividends. It

is convenient for some people to be able to cover up blunders this way, but Section 49 provides the proper method for dealing with capital, which has been lost. We all make mistakes, but they should be dealt with as the law requires. We all know that certain forms of capital expenditure are not represented by tangible assets, and other forms can be classed as "development expenditure," but that is not what is envisaged here. Here, we have in mind fruitless capital expenditure. Why invest in or give credit to a concern, the management of which expects to make such blunders that it plans from the start to be able to dispose of them quickly by charging "distributable surplus?"

Some say that it is a convenience to have a fund, out of which they can give a "hand-out" to shareholders, during times that the company is earning no profits. These times may be during the first one or two years of operations, or may be later. In other words, the company takes money from the shareholders' savings, which it does not need for its own operations, because if it did it would credit it to capital. This money is saved in the company, so that it may pay something to shareholders, when no profits have been earned out of which dividends can properly be paid. In other words the company acts as a savings bank, without being subject to the special legislation for savings banks, and the shareholders (the depositors) cannot withdraw their savings at will, but as the directors of the company think fit. These companies should not impinge on the province of the savings banks, and it should be made illegal for them to do so under this or any other pretext, supposedly paternal.

The fact is that it is within the law for a company to be formed to work a project which never had and never will have any prospect whatsoever of earning profits, for this company to issue shares, with "distributable surplus" as part of their consideration, and to pay thereon good attractive dividends. Good-sized dividends usually enhance the market-value of shares, and if the shareholders, who are friends and relatives of the directors, sell out at high prices they have done nothing illegal, but will have made a large profit. After a few years the company goes into liquidation, and those remaining of the original shareholders find that of their original contribution of funds they have only saved the dividends paid out of "distributable surplus." These dividends may only amount to a fraction of the "distribut-

able surplus," because some of it may have been used for dividends on preferred shares, there being no legal provision that dividends out of this "surplus" can be paid only to the class of shareholders who contributed it. The shareholders, who bought the no-par-value shares at enhanced prices, will be in a worse case because they did not get the first dividends and paid more than the original price. The shareholders at the liquidation find themselves holding little more than an empty shell. Of course, honest directors would not carry through such a scheme as described, but are all directors continuously honest in mind? Again, why make fraud legal and easy? The law ought to make things as difficult as possible for those who wish to swindle their fellow-men out of their savings.

It is suggested that no new company should be allowed to set aside a portion of the consideration of no-par-value shares as "distributable surplus" unless (*a*) it is substantially a continuation of a concern, which has undistributed surplus in its balance sheet, or (*b*) it has been carrying on its regular operations for at least two years and its accounts show that it is earning more than normal profits. Normal profits could be fixed at a percentage on the capitalization, say five or six per cent.

Before issuing shares under these conditions the company should be compelled to file at Ottawa audited statements and accounts to prove whichever set of circumstances applies. It should also file a copy of them in its own permanent records.

The meaning of Section 12, subsection 7, which deals with "distributable surplus" is very obscure. It provides (*a*) for the setting aside of 25% of the consideration as "a distributable surplus" and, (*b*) where the company acquires a going concern, for the setting aside of a part of the consideration equal to the "unappropriated balance of realized net profits of the going concern immediately before such acquisition." In the 1934 Act the words dealing with the two amounts to be set aside (*a* and *b* above) were linked up as follows:—

> ". . . may be set aside as a distributable surplus; *provided that in addition* where the company acquires a going concern. . . ."

and the fact that (*b*) is additional to (*a*) is emphasized as follows:—

> ". . . the directors may by resolution set aside such *further* part of the consideration. . . ."

In the amending Act of 1935 the words italicized are omitted. Why? As it stands, the writer believes that two interpretations can be given to this subsection:—

(1) The purchasing company can set aside 25% *plus* a sum equal to the surplus in the balance sheet of the going concern acquired:

(2) The above can be two alternatives, that is to say 25% *or* a sum equal to the surplus as above. The omission of the words referred to seem to imply this, and conservative accounting will prefer this interpretation.

Surely, it should be possible to express the law more clearly than has been done in this subsection; it ought to be comprehensible to ordinary citizens, because they pay for the framing of it, and are the final source of power for its enactment.

Section 61 is also obscure. This is partly due, to a confusion of terms, and partly to the legislators having intended to capitalize two lots of profits, but of having only dealt with one of them. Firstly, may we state what we mean by certain terms. The vast majority of the greatest and most distinguished writers on accounting, when they use the words "Capital" or "Revenue" in connection with a profit, intend thereby to signify the nature of the transaction out of which it arose. The following definition of Revenue or Earned Profits appears to combine and coordinate the opinions of the most conservative authorities:

> "The net revenue or earned profit or income of a business for a period is the surplus remaining from the earnings resulting from the regular operations of the business after providing for all known, paid and accrued, and probable costs, expenses and wastages, resulting from the regular operations of the business during that period. It will also include revenue by way of dividends or interest from investments outside the business belonging to that period."

Revenue Surplus is an accumulation of revenue profits. According to the same authorities capital profits may arise

out of capital transactions or happenings; that is to say, transactions in the capital assets, capital liabilities, capital stock or funds of a concern, or a transaction concerning the sale or purchase of substantially an entire undertaking. Accordingly, capital surplus, which is an accumulation of capital profits, may arise out of the following:—

(*a*) Profit on the sale, acquisition, revaluation of a capital or fixed asset;

(*b*) Profit on the sale, or acquisition of current assets in the sale or acquisition of substantially the entire assets of an undertaking;

(*c*) Profit on the redemption of a capital liability at less than its "present net worth" to the borrower;

(*d*) Profit on a transaction concerning the capital stock of a company.

It may also arise out of a gift of funds or of an asset for capital purposes.

Capitalized surplus, as its name indicates, is surplus, which has been capitalized, say by the payment of a stock dividend. It could be defined as follows:—

"Capitalized surplus is surplus, no matter whether it resulted from capital or revenue transactions, or from contributions, which have been appropriated, so that it forms a part of the permanent capital investment of the concern, and accordingly can not be distributed by means of cash dividends or used for the purpose of writing off of losses except on a reduction of capital as provided for under the company law concerned."

It is evidently the intention of Section 61 of the Dominion Companies Act to provide for the capitalization of surplus used for the redemption, or purchase for cancellation, of preferred shares. Where preferred shares are redeemed by means of an appropriation of surplus, and such redemption results in a profit, there are two items of surplus concerned:—

(*a*) the net profits or surplus, which are represented by liquid assets available, and which are used for the redemption, and

(*b*) the excess of the par value of the preferred shares over the figure at which they were redeemed.

That is to say, if $100 preferred shares are repurchased at $90, then (*a*) = the $90 paid in cash, and (*b*) = the $10 capital profit.

Now the fifth line from the end of Section 61 contains the following words:—

> "the surplus *resulting from such redemption or purchase* shall be designated as a capital surplus, which shall not be reduced or distributed by the company except as provided in sections forty-nine to fifty-eight, both inclusive of the Act."

The words italicized indicate (*b*) only. The surplus appropriated (*a*) was in existence already. Yet (*a*) the surplus appropriated for the redemption will replace the preferred stock redeemed in the balance sheet, and should be regarded as capitalized, no matter whether such surplus originally arose out of capital or revenue transactions. It is probable that this is what was intended in the Act, although it is not stated. In the interests of sound accounting and finance the following amendment of the last five lines of Section 61, by the insertion of the words italicized, is suggested:

> "And *any* surplus resulting from such redemption or purchase for cancellation *at less than the par value of the shares together with the ascertained net profits of the company which had been set aside by the directors for the purposes of such redemption or of such purchase for cancellation* shall be designated as *capitalized* surplus, which shall not be reduced or distributed by the company except as provided in sections forty-nine to fifty-eight, both inclusive, of this Act."

The account to be credited could be entitled:—

"Preferred Share Redemption Surplus: Capitalized."

This item should be grouped with the common and preferred stock capital.

While referring to the different kinds of profits and surplus, it is well to point out the desirability of keeping realized and unrealized profits in separate accounts. By "realized profits" is meant profits which are represented by cash or an obligation to pay cash at the present or a future date, or as one writer puts it, "profits tangible for the purpose of division." Profits may have been realized at one time, but later may have become invested in fixed

assets, in which case they are evidently not available for distribution, excepting by way of stock dividends. Some writers contend that "there is no profit without realization," and all are agreed that unrealized profits must never under any circumstances be used as supposed justification for the payment of a cash dividend. Because of their nature, practically all revenue profits must be realized profits, but capital profits may be both. For example, the sale for cash of a factory building at more than its net depreciated book value will result in a realized profit, whilst an appreciation in value on the re-valuation of a land site will result in an unrealized profit. It is wisest to transfer unrealized profits to some reserve to cover losses on the asset which had been re-valued. Certainly, the two kinds should not be mixed up in the one account. The Dominion Companies Act recognises unrealized profits in Section 77, subsection 3, requiring their exclusion from the report called for. It is suggested here that, just as the Dominion Companies Act requires capital profits and revenue or earned profits to be recorded separately, so should it require unrealized profits to be recorded separately from the realized.

Redemption of Preferred Shares

The redemption of preferred shares at a figure less than par by purchase at current market price is a matter, the ethics of which are extremely questionable. Some companies have such a power, and exercise it during times when depressed profits cause their preferred shares to stand low on the market. By this means the remaining shareholders make a capital profit out of those who have sold out. They might be all in the same class, but at least are all shareholders risking their capital. The remaining shareholders make their profits out of their brother shareholders, not because the company has done something good, but because its finances have a bad showing and its shares are depressed on the market. If capital has been lost so that the shares should be written down, the loss should be borne equitably by all concerned. Proper permission should be obtained as laid down in the Act, and the shares should be written down so that each holder takes his fair share. Shareholders are part-owners and risk their capital: they are not in the same class as bondholders, who are lenders of money, and have a prior claim for the security of their

capital. It is suggested that a company should not be allowed to redeem its preferred shares at a figure less than par. In many cases the figure should provide for dividend rights as well as repayment of capital; but it should be made illegal for a company to obtain profit for its remaining shareholders by means of its own shortcomings.

Unissued Shares

It is a general principle of sound accounting for company finance that unissued shares simply represent an unexercised privilege to ask the public for money. The shares may never be issued, and cannot be properly valued in the balance sheet, any more than one can value the privilege which every citizen possesses of being allowed to run into debt. Just imagine the balance sheet of a private individual containing the following items:—

Right to run into debt $1,000,000	Liability which I would incur if I ran into debt...$1,000,000

And yet there are companies, who would show unissued shares on the assets side at their par figure, with the full authorized capital on the liabilities side, and this is hardly less ridiculous.

A company should not be spoken of as selling its shares, because until the shareholder has subscribed them they have no value which can appear among the assets of the balance sheet. The company issues its shares, and the subscriber renders himself liable to contribute to the capital funds or assets of the company.

The Act should be amended requiring that, for the purposes of the balance sheet and books of account, unissued shares of a company are to be deemed of no value.

This principle, and its accompanying one that a company cannot own its own shares, should be adhered to, right through company legislation, with as few exceptions as is possible. With this end in view it is suggested that Section 42, subsection 2, should be amended to read as follows; the new words being *italicized:*—

(*a*) *Any moneys paid up* on such shares so declared forfeited shall *remain* the property of the company, and subject to any provisions of the by-laws of the company, such shares *may be re-issued* or otherwise disposed of in such manner as the directors think fit.

This avoids the statement that they, the shares, become the property "of the company."

In conclusion, it is obviously wise for the government, before making changes to the Dominion Companies Act, to continue the policy of consulting such bodies as the accounting and legal professions, the banks and those which advise upon the granting of credit, the universities, and so on, and to do this through the councils or proper representatives of these bodies. The men, whose opinions and advice will be tendered by these bodies, will be men who for years have studied company law, have worked under it, and know very well its defects and possible improvements.

THE DAIRY INDUSTRY IN CANADA
CHEESE

By C. W. Saddington, Chartered Accountant
Toronto

[EDITOR'S NOTE—This is the fourth of a series of articles on the Dairy Industry in Canada written by Mr. Saddington and published in this Magazine. The previous ones were: "The Romance of Milk" (June 1936), "Production Records for Dairy Plants" (August 1936), and "Butter" (December 1936)].

In this paper as in that on butter, the subject will be dealt with in two phases, the first pertaining to world trade and the second, the Canadian outlook.

Different Kinds of Cheese

In dealing with this subject, it must be remembered that while we, in Canada, are principally interested in Cheddar cheese, there are many other kinds which compete with ours in the markets of the world. A few of the well known are:

Edam from the Netherlands
Gruyere from Switzerland
Gouda from the Netherlands
Parmesan from Italy.

These are all what are called hard or hard pressed cheeses. In addition, there are medium soft cheeses such as Stilton, Roquefort and Gorgonzola, and soft cheeses such as Camembert and cream cheese. In recent years Process

cheese has been developed which is really not a new kind but a blend of Cheddar cheeses of different maturities.

Consumption of Cheese in Various Countries

The following schedule from *The Handbook of Dairy Statistics* published by the United States Department of Agriculture shows the per capita consumption in various countries in certain years.

Country	*Year*	*Per capita Consumption*
Switzerland	1930	16.1 pounds
Netherlands	1930	14.3 pounds
Denmark	1931	13.1 pounds
Italy	1928	12.1 pounds
Norway	1929	10.8 pounds
Germany	1928	10.6 pounds
France	1931	10.5 pounds
Sweden	1929	10.2 pounds
Great Britain	1930	8.5 pounds
New Zealand	1930	4.8 pounds
United States	1931	4.5 pounds
Australia	1930	4.3 pounds
Canada	1930	3.7 pounds

As a probable partial explanation of these wide variations in per capita consumption, the following paragraph taken from a report on the marketing of cheese in England and Wales and published by the Ministry of Agriculture and Fisheries may not be out of place.

"The demand for cheese is heaviest in those districts where the mass of the population is engaged in heavy manual labour. The industrial districts in the North, the Midlands and South Wales are thus important markets for cheese, while the consumption per head is also high in rural areas; the demand is for the lower priced cheeses which are often eaten instead of meat. Elsewhere a greater range of varieties and qualities is in demand but the total quantity of cheese consumed per head is less."

This statement leads to certain conclusions as set out below, which to some extent are borne out by the per capita figures.

(1) That consumers of cheese may be roughly divided into two classes; (a) manual and rural workers who eat it as

a staple food, and (b) others who eat it as a condiment or relish;

(2) That those using it as a staple food eat much more per head than the others who use it as a relish;

(3) That as the standard of living rises less will be consumed per head of population but in greater varieties;

(4) That the large consumers are, in most cases, in a low wage bracket and that therefore it must be sold at a fairly low price.

Trends in Consumption

There are no statistics available, so far as known, as to the total consumption of cheese but the total of the world's exports may be used as a guide in this connection. In addition, as the United Kingdom is the largest importer of cheese, a comparison of the imports into that country will be informative as to the trend in consumption there, but this latter figure will not be a sure guide as the milk marketing board have been trying to increase the production of cheese in England but the trend will be indicated.

The following figures for total cheese exports of various countries are taken from *A Handbook of Dairy Statistics.*

		1,000 lbs.
Average years	1923-1927	685,100
year	1927	727,613
year	1928	730,631
year	1929	748,163
year	1930	731,786
year	1931	705,367

These figures show an expansion in the exports of cheese of about 2.9% between the first and last periods which would indicate for practical purposes that there has been very little rise in consumption. Butter figures from the same source and for the same period show an expansion of 34.5%.

The following figures give the imports of cheese into the United Kingdom for the years indicated:

Year	*Ending 31st December*
1928	3,005,237 cwt.
1931	2,884,757 cwt.
1933	3,039,667 cwt.
1934	2,988,567 cwt.
1935	2,713,322 cwt.

From these figures, it can be seen that there has been no increase in the total importations of cheese but rather that there has been a slight decrease each year since 1933. Going back to earlier years, we find that in 1900 the imports were about the same as in 1935. These figures would seem to indicate that the consumption of cheese in the largest importing nation is practically at a standstill with a slight trend downward. Prices in the period covered have varied with no appreciable change in quantity so that this factor need not be considered as affecting the trend.

From the figures given it is submitted that the outlook for the cheese industry is not bright unless new markets are found. Total imports into the United Kingdom which is the principal importer at present are not growing but are rather decreasing and price does not appear to have much effect in either increasing or decreasing the quantity. Also as the standard of living rises, this tendency to decrease consumption may be further accelerated. In addition the milk marketing board in England may be able to displace some of the imports by cheese made at home. This means greater competition for the available surplus production or the finding of entirely new markets which are not at present using cheese.

The outstanding fact in regard to Canadian trade in cheese is that in 1904 we made about 221,000,000 pounds and in 1935 about 100,000,000 pounds. Our exports of cheese in the same years were about 234,000,000 pounds and 53,000,000 pounds respectively. This drop has not been sudden but of a more or less steady nature from year to year. To illustrate the decline, the Canadian exports of cheese are shown below for certain years since the peak year of 1904.

Year	*1,000 lbs.*
1904	233,981
1909	164,907
1914	144,478
1919	152,207
1924	121,465
1929	92,946
1934	61,168

The United Kingdom has always been our best customer and as it has been shown that the world imports into Great

Britain have not increased or decreased in quantity over this period to any appreciable extent, it necessarily follows that some other country has supplanted us in supplying a large part of the British cheese requirements. That country is New Zealand and the growth of their cheese exports is shown in the following table:

Year		*Total Exports of Cheese from New Zealand*	*Exports to United Kingdom*
1904	......	84,526 cwt.	82,046 cwt.
1908	......	280,798 cwt.	276,212 cwt.
1913	......	611,663 cwt.	608,933 cwt.
1923	......	1,441,460 cwt.	1,428,762 cwt.
1928	......	1,567,272 cwt.	1,551,523 cwt.

These facts do not necessarily mean that we have lost this trade through competition as in this period, more remunerative uses may have been found for this milk in Canada but they do mean that in the future, once our own needs are satisfied, we will have to compete in a market largely lost to us, with a sister Dominion very efficient in the manufacture and marketing of dairy products. This is the point at which the dairy industry presently stands in Canada. As pointed out in the paper on butter, we are at the present time producing more butter than we are using ourselves. This has been the case so far as cheese is concerned for years and it also applies to evaporated and condensed milk and other products. The question now is "Are we going to retire behind our own boundaries and produce just enough for ourselves, or are we going to produce and find markets for our products throughout the world?" The only answer to this question for a country such as ours is in the affirmative to the last alternative. Accordingly, in order to compete with the other great dairying countries of the world, there are certain definite corrective steps to be taken, some of which may be listed as follows:

(1) The industry as a whole should be guided to more intensive production and manufacturing to reduce costs.

(2) Some way should be found to equalize exchange rates as at present some of our competitors have an advantage because of depreciated currencies.

(3) Our transportation costs should be reduced as our long railway hauls give a decided advantage to our competitors.

More Intensive Production and Manufacturing

In previous papers, attention has been drawn to the low average production per cow and how little is being done by testing associations to improve matters. It should therefore be repeated that more could and should be done from this angle, not on isolated farms only but generally.

In discussing butter, attention was directed to the small factories which, based on operating standards set by other countries, are inefficient and do not lend themselves to proper control of quality so necessary for international trade.

To show that the same condition applies to cheese, the following schedule is taken from *Statistics of Dairy Factories, 1934*, published by the Dairy Statistics Branch of the Dominion Bureau of Statistics at Ottawa.

Classification of Cheese Factories
According to Quantity of Cheese Made

Territory	*Total Factories*	*under 100M lbs.*		*100M to under 200M*		*200M to under 300M*		*300M to under 500M*		*500M and over*	
		No.	*%*	*No.*	*%*	*No.*	*%*	*No.*	*%*	*No.*	*%*
Maritimes	16	16	100								
Quebec ...	360	348	96.6	12	3.4						
Ontario ..	648	405	62.5	202	31.2	29	4.5	9	1.4	3	.4
Western .	29	21	72.4	6	20.7	2	6.9				
	1053	790	75.0	220	20.9	31	2.9	9	.9	3	.3

This schedule shows that 75% of our cheese factories are making less than 100,000 lbs. but 100,000 lbs. is a fair output. For this reason, the average production per factory in each of the same territories is given in the following schedule.

Average Output Per Cheese Factory

	No. of Factories	*Quantity Made—lbs.*	*Average per Factory—lbs.*
Maritimes	16	631,921	39,495
Quebec	360	13,768,510	38,246
Ontario	648	66,021,713	101,885
Western	29	2,131,256	73,492
	1053	82,553,400	78,398

The usual margin to cover the cost of manufacture and profit is from $2\frac{1}{2}$c to $2\frac{3}{4}$c per lb. and based on the highest average per factory this would amount to between $2500 and $2800 and on the lowest from $950 to $1050. It can be seen therefore that very few of our cheese factories are paying propositions even though a great number only operate during the summer months and the cheapest of equipment and buildings used.

It does not necessarily follow that large plants are more efficient but the above figures do show that our average factory is too small. Due to our scattered farming communities and the fact that milk is a bulky product for transportation it is perhaps not possible to concentrate cheese production in very large factories but it is submitted that any corrective action undertaken should have this end in view.

Equalization of Exchange

As stated previously in this paper, our greatest competition is coming from New Zealand and the £ in this Dominion is at a heavy discount in relation to the English £ whereas Canadian money is practically at par. Theoretically this should not matter as the discount should be offset by higher prices in New Zealand, but actually is this the case? Let us examine a hypothetical example where the importer in Great Britain pays 60 shillings or £3 for a cwt. of cheese.

The Canadian exporter would receive at $4.92 to the £, 13.28c per lb. of cheese.

The New Zealand exporter would receive a premium of about 25% or 75 shillings, or 16.47c per lb. of cheese. It is probable that a certain part of this advantage would be lost through higher prices in New Zealand but it is questionable if all would be used up in this way. In addition there is the mental attitude to be considered. We all know the effect on our trade when we received $5.00 to $5.10 for each £'s value of goods sold to Great Britain.

This disparity in exchange rates is beyond us to rectify but it should be kept in mind when our export trade is considered.

Transportation Costs

The production of cheese in Ontario and Quebec accounts for about 97% of all cheese made in Canada. Also it will be

found that most of the cheese made in these two provinces is within a radius of about 250 miles of Montreal. In Ontario approximately 80% of the cheese made is manufactured east of a line drawn between Pembroke and Belleville. This concentration of manufacture may be due to various causes but one of the chief reasons for it is the proximity of the district to the harbour of Montreal for export. On this basis the longest rail haul is about 250 miles. Contrast this with the average rail haul or the boat transfer in New Zealand and it will be found that so far as transportation to the sea-board is concerned we in Canada are at a disadvantage. Again while New Zealand is much farther from Great Britain by sea than is Canada, it will be found that the ocean shipping rates are nearly equal. There is therefore no advantage to us in the short sea voyage. As explained, New Zealand has a distinct advantage in respect to transportation costs. The problem we face is a difficult one but a solution or correction must be found else it will be increasingly difficult for us to compete with that country.

These are a few of the problems in the Canadian cheese industry, and it is hoped that the discussion thereof will be of help to the members of the Association.

REVENUE AND EXPENSE STATISTICS IN A BROKERAGE OFFICE

By Gilbert A. Doe, Chartered Accountant, Toronto

STATISTICAL information as to the trend of profits or losses must be kept up to date in order to be of value to the stock broker. In the brokerage business both revenue and expenditures may be classified as either fixed or variable provided the term fixed is allowed a little elasticity, which, it may be considered, is not inconsistent when the information is prepared for statistical use only.

The following gives an idea as to how the above classification applies to brokerage house accounting:

	Variable	*Fixed*
1. REVENUE:	Commissions—Stocks Commissions—Grain Commissions—Commodities	Interest (net)
2. EXPENDITURES:	Printing and stationery Mailing charges Staff meals Postal insurance Supplies Repairs Long distance calls Telegraph tolls etc.	Salaries Rents Telephones (except long distance calls) Statistical services Insurance Dues and assessments Ticker services Leased wires, etc.

The above classifications are not intended to be complete, but merely to indicate a method of assembling the data required to prepare the proposed statistical records.

In any application of the methods outlined herein, adjustments would of necessity have to be made to take care of local conditions. One example should suffice—the matter of distributing head office overhead between head office and branches. In some cases this is not even attempted, but it is usually considered that head office is entitled to a proportion—say 10% or 15%—of branch commissions, to compensate head office for expense of bookkeeping, etc. (This assumes that accounting for the branch business is done mainly at the head office.)

Revenues—Brokerage revenues are mainly commissions and interest. Commissions, of course, depend entirely on

the volume of business executed and must be built up from daily reports and accumulated to give weekly and/or monthly totals. Separate totals should be accumulated for each branch and for the various classes of business transacted, if desired, such as Stocks-Listed, Stocks-Unlisted, Winnipeg Grain, etc.

Interest revenues from month to month depend on the total customers' margin account debits, money borrowed, etc. By a study of the actual figures for, say, the last six months, an intelligent estimate of the interest income for the next ensuing month may be made. Factors to be considered are:

1. Number of days in the month for which the estimate is being prepared
2. Trend of customers' debits (up or down)
3. Trend of interest rates.

Having arrived at an estimated figure for the month, it should be divided by the number of business days in the month to arrive at the daily figure. While interest is earned on Sundays and holidays, it is better to spread all the interest over the business days. It can now readily be seen that, knowing the estimated interest revenues for one day or one week, it is a comparatively simple matter to determine at the close of each business day the total revenue, commission and interest, for the day, week to date, or month to date.

Expenditures—After computing the daily total revenue figure, a daily expense figure is necessary to determine daily operating results. Briefly, the suggested method is to build up an estimate of the expense for the ensuing month by taking the following factors into account:

(a) As to variable expense:

1. By analysis and averaging previous six months' figures (adjusting for non-recurring items.)

2. Adjusting for length of month, where necessary.

(b) As to fixed expense:

1. These, in the majority, are monthly charges and present no difficulties.

2. If salaries are paid weekly, salary figures must be brought in line with length of month.

The application of the above principles, where a modern accounting system of distributing expense monthly is maintained, will facilitate the determination of a reasonably accurate forecast of the ensuing months' expenses. Daily and weekly figures are secured by the method outlined above; in the matter of interest, divide by the number of business days in the month. It should perhaps be pointed out that for obvious reasons it would be impracticable to include any of the following in estimated expenditures:

1. Partners' interest
2. Error account
3. Provision for doubtful accounts
4. Provision for contingencies

The following information may now be set out in tabular form. Figures given are, of course, merely illustrative.

		MONTH	WEEK (6/26 of month)	DAY (1/26 of month)
REVENUE:	Commissions	x	x	x
	Interest	$1170	$270	$45
EXPENSES:		$7020	$1620	$270

(Month had 31 days, less 4 Sundays and 1 holiday)

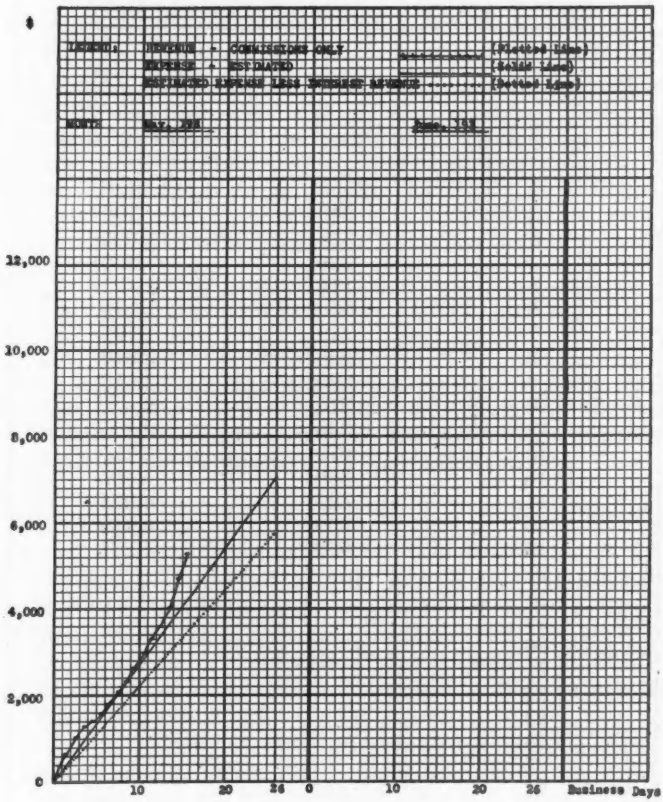
From the above it is possible to see at a glance the daily, weekly or monthly volume of commissions which the brokerage house must earn in order to show a profit. Using the monthly figures as an example and deducting the estimated interest revenue from estimated expenses ($7020 — $1170), a "deadline" figure of $5850 is reached. The profit (before adjustment due to error account, etc.) for the month will therefore be approximately the amount by which commissions actually earned during the month exceed $5850. A very satisfactory method of illustrating this is by means of the following Graph.

This graph was prepared from the following tabulated information:

Estimated	Operating expense for month	$7,020
	Interest revenue for month	$1,170
Actual	Commission earnings required to meet operating expense	$5,850

MONTHLY REVENUE & EXPENDITURE GRAPH

(SHOWING DAILY ACCUMULATION COMMISSIONS EARNED)



DAILY RECORD COMMISSIONS EARNED

Month—May, 193-

BUSINESS DAYS	DAY	MONTH TO DATE
1	$400	$ 400
2	300	700
3	325	1,025
4	225	1,250
5	175	1,425
6	150	1,575
7	220	1,795
8	245	2,040
9	275	2,315
10	315	2,630
11	345	2,975
12	275	3,250
13	350	3,600
14	425	4,025
15	600	4,625
16	650	5,275
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		
26	Month to date Adjustment	
	Total	$

A graph such as this is simple to prepare and keep up to date, yet it gives the busy executive the very information

he requires at a glance. It lends itself equally well to comparative purposes or to branch office operating data.

Where it is desired to show weekly operating results a simple plan is to tabulate commissions earned weekly and compare with the weekly estimate of expense less interest.

The above outline may seem extremely simple and academic to the accountant of long experience. However, in the writer's opinion, the preparation of statistical information should not require too meticulous detail, else the cost and trouble of securing the data outweigh its usefulness.

GENERAL NOTES

The Annual Meeting

At the time our September issue went to press the annual meeting of The Dominion Association of Chartered Accountants was in session at Vancouver. A report of the meeting will be published in our October issue.

Our Contributors This Month

GILBERT ASHER DOE is drawing from his practical experience in giving the interesting article on Revenue and Expense Statistics in a Brokerage Office which appears in this month's issue. At the time of his admission to the Institute of Chartered Accountants of Ontario in 1932 he was with Gunn, Roberts & Co.

J. R. HENDRY of Montreal who writes on Food Cost Accounting for Hotels, Restaurants and Hospitals, received his early education in Scotland. He is a graduate of the School of Commerce of McGill University, and has been with McDonald, Currie & Co. since becoming a member of the Society of Chartered Accountants of the Province of Quebec in 1932.

PROFESSOR D. C. MACGREGOR of the Department of Political Science of the University of Toronto, who has concentrated his studies on various aspects of public finance, gives in this issue an illuminating account of the financial system of the Union of Socialist Soviet Republics.

Charles Wingfield Saddington who has written a number of articles in previous issues on the dairy industry in Canada, this month tells us something about cheese. He is chief accountant with the Confederation Life Assurance Company of Canada, Toronto.

Robert R. Thompson who, in our issue of January last, wrote on the debt of culture to commerce, this month explains why in some respects the Dominion Companies Act can be and should be improved. He is Professor of Accountancy at McGill University.

LEGAL DECISION

[Editor's Note: The following judgment of the Exchequer Court of Canada is published in the Canada Law Reports, Part IV, 1937.]

Income tax—Transfer of property in fulfilment of marriage contract is not a transfer to evade taxation

(Executors of the will of Kenneth Molson v. *Minister of National Revenue)*

Exchequer Court of Canada

By his marriage contract entered into on 28th March 1913, wherein separation as to property was stipulated, Kenneth Molson, resident in Montreal, P.Q., made to his future wife a donation *inter vivos* of the sum of $20,000. By a deed made on 23rd March 1925, the said Kenneth Molson in fulfilment of the conditions of his marriage contract with respect to the said donation, transferred and conveyed to his wife certain shares of the capital stock of various corporations, the wife accepting such shares in full payment of the sum of $20,000. The returns of income he made for the years 1925 to 1931 inclusive omitted the income derived from these shares. He died on 9th April 1932.

On 11th April 1933, the Commissioner of Income Tax sent notices of assessment to one of the executors of the will of the said Kenneth Molson, assessing the dividends paid on such shares between 23rd March 1925 and 31st December 1931.

Held: That the conveyance made by Kenneth Molson to his wife was not a transfer to evade taxation; it was made in fulfilment of his marriage contract and from the date of transfer he had no further interest in the shares transferred to his wife and was no longer liable to taxation on the income derived therefrom.—[1937] Ex. C.R. 55.

PROVINCIAL NEWS

BRITISH COLUMBIA

At a meeting of the Council of the Institute held on 20th July the following officers were elected for the year 1937-38: President, George F. Gyles; Vice-President, E. C. Mapson; Secretary-Treasurer, H. N. Lunn. The representatives appointed to the Council of The Dominion Association were George E. Winter, George F. Gyles and E. C. Mapson.

SASKATCHEWAN

The twenty-ninth annual meeting of the Institute of Chartered Accountants of Saskatchewan was held at the Hotel Saskatchewan, Regina, on Friday, 25th June 1937. A good representation from the various parts of the province attended.

The President, Mr. J. H. Thompson, reviewed the activities for the year ended 31st May 1937, and the Secretary, Mr. W. E. Hodge, reported on the finances, membership and several other matters.

The following were honoured by being elected Fellows of the Institute: W. J. Dawson and L. Jacobs, Regina, and J. H. Thompson, Saskatoon.

The election of officers and Council for the ensuing year resulted as follows:—

President, W. C. Jeffery, Weyburn; Vice-President, T. E. Robinson, Regina; Secretary-Treasurer, T. H. Moffet, Regina. Members of Council—W. C. Jeffery, Weyburn; T. E. Robinson, W. J. Dawson, T. H. Moffet and R. R. Thomas, Regina; W. Stempel, J. H. Thompson, and George C. Patrick, Saskatoon; and M. Hesford, Swift Current. Auditor, H. F. Bancroft, Saskatoon. Representatives on Dominion Coun-

cil—W. C. Jeffery, Weyburn; W. E. Hodge, Moose Jaw; and T. E. Robinson, Regina.

The President, Mr. J. H. Thompson, presided at the annual luncheon of the Institute, at which Hon. W. F. Kerr, Minister of Natural Resources for Saskatchewan, gave an address. He spoke on the assets and liabilities of our Province, stating that at this time one of our greatest assets was the character of our people and that one of our principal liabilities was the mistakes of the past, such as, the opening up for cultivation of land in the drouth area.

In the evening the Regina and Moose Jaw members entertained the out-of-town members at dinner and were addressed by Mr. Harold Fry.

OBITUARY

The Institute of Chartered Accountants of Ontario regrets to announce the death, after a short illness, at Hamilton, Ontario, on 9th August of Andrew Forrest Dowie in his seventieth year.

The late Mr. Dowie was well known as a partner in the firm of C. S. Scott & Co., Chartered Accountants, Hamilton, and had been a member of the Institute since 1925.

The Institute extends to his relatives and business associates sincere sympathy in the loss they have sustained.

TERMINOLOGY DEPARTMENT

The articles in this department, unless otherwise stated, are written by the Chairman of the Terminology Committee. The views expressed are those of a majority of that Committee, and therefore must not be taken necessarily as those of each member.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

THIS month we give the first instalment of what is intended to be, as complete as is reasonably possible, a dictionary of Accounting terms. The definitions given have had the consideration of the members of the Committee, and are now submitted for general consideration. Criticisms (especially constructive ones) and suggestions are invited by the Committee, and should be sent to the Secretary. It is hoped that this dictionary eventually will be made up in book form—probably in loose leaf pages issued in serial instalments.

Above par: Par means equal. As applied to Stocks and Bonds "par" indicates that the market value is equal to the face value, therefore "above par" indicates that the market value is greater. A synonymous expression applied to such securities is "at a premium."

Acceptance: (1) A bill of exchange drawn by one party called the drawer on another called the drawee, to which the drawee has signified his assent by inscribing the word "accepted" (usually with some indication as to the place where payable) and his signature. (2) A term used in contract law, the complement of an "offer."

Accommodation Bill — or Note: A draft accepted or note given by one party to another without consideration between them, solely for the purpose of enabling one of them to obtain credit or receive ready money; usually looked on with disfavour by Bankers unless they are convinced that the accommodating party fully understands that he has made himself liable for the amount, and are satisfied as to his financial responsibility.

Account (and Accounts): (1) The records of business transactions as shown in the pages of a ledger. (2) A collective term used for the annual or periodical statements

of a business as presented to the proprietors. (3) In the singular, a term colloquially used for the copy of an account sent to a debtor; more correctly, a "statement of account."

Accountancy: The science (or art, according to individual preference) of recording financial transactions of business or other organizations, preparing from such records statements showing the progress and standing as to the worth of the business, analyzing such statements and drawing therefrom inferences or conclusions for the information of proprietors and management or others concerned, and determining costs. The term is also used to describe the Accountants' profession.

Accountant: One skilled in Accountancy.

Account charge and discharge: A method of accounting used by trustees—principally in Scotland—by which a trustee "charges" himself with the assets and all revenues of the trust, and accounts for them under the heading "discharge," any balance representing the remainder of the estate still in his care.

Account Current: A statement of account rendered by one trader (or other person) to another at periodical intervals in cases where it is unusual for a definite settlement or "stop" to be made (current means "running") e.g., with correspondents in different countries. It is usual for the parties to agree on the balance shown; until such agreement is arrived at the expression "Open Account Current" is used. An agreed Account may be called an "Account Stated."

Account Payable: An amount owing to a creditor on current terms of payment, as distinct from notes, mortgages or other liabilities of a special nature.

Accounting party: Anyone who has business connections with another under agreement to render at fixed intervals an accounting of transactions within the scope of the contract.

Accounting period: Briefly, any period in respect of which accounts are prepared. In any organization, the period, from date to date, chosen for the preparation and consideration of statements of its finances and revenues. For management this may be at one month, three months or other intervals; for shareholders or proprietors it is

usually annual. The latter is sometimes called the "fiscal" period; strictly, however, this term applies only to Governmental Accounting.

Accounting unit: A department, section, or branch of a business or organization in respect of which a separate set of accounts is maintained.

Account Receivable: An amount owing by a debtor on current terms of payment, as distinct from notes, mortgages, or other liabilities of a special nature.

Account Sales: The statement rendered to a consignor of merchandise by the consignee giving particulars of the sales of such merchandise, the gross proceeds therefrom, the expenses incurred, the consignee's commission, and the net amount due the consignor; usually accompanied by a remittance for this amount.

Account stated: An account the balance of which has been accepted by the debtor, explicitly or impliedly, as correct. Once so accepted, it would require the strongest evidence on the debtor's part to impugn it; being really an admission of liability. "An account stated is nothing more than the admission of a balance due from one party to another; and that balance being due there is a debt. The statement of an account and admission of the balance implies a promise, in law, to pay it." (*Irving* v. *Veitch,* 1837, 3 M. & W. 106).

Accretion: In British practice, a term used to mean what was understood in Roman law by "accresco," a kind of increase. Thus, the offspring of animals, the produce of the soil, the increase of land by alluvial deposits, and similar things are examples of accretion. (Pixley's Accountants' Dictionary). In American practice, additions due to the operation of a plan formulated for the purpose of accumulating funds, e.g., a pension fund, the accretions to which may result from (a) the setting aside of a percentage of the payroll and (b) income upon the investment of funds so set aside. Accretion must be distinguished from appreciation and increment ("Accounting Terminology," New York 1931).

Note the definition given by the Concise Oxford dictionary:—"Growing by organic enlargement; the growing of separate things (as particles) into one; the whole resulting from this; adhesion of extraneous matter to anything; the matter so added."

Accrue: Similar in derivation to "accretion," meaning to grow or increase. In Accounting it refers in particular to the growing amount by effluxion of time of interest on a debt and similar matters (see "Accrued"). "Accrual" is the act or progress of accruing; that which has accrued; increase.

Accrued: An adjective denoting the proportionate amount of growth (see Accrue) to a date stated; e.g. Accrued Interest, —Dividend, —Depreciation, —expense, —income, etc. Generally, it refers to a growth to an interim point; e.g., Accrued Interest is that to some point between due dates; on due dates it is charged (or credited, as the case may be) and becomes "Interest due."

Accumulated Profits: Undistributed Profits; Earned Surplus. (q.v.)

Acquittance: A discharge in writing of a debt; a release; a receipt in full of account.

Active Debt: A term used in British practice to indicate a debt on which interest is paid, one which is only claimable as such without interest being called a "passive" debt. It is probable that in Canada the term would be understood to refer to an account which is actually "working" or "active," with charges, credits and remittances at frequent intervals, in contradistinction to one with an old outstanding balance, possibly doubtful or bad, and which might be called "inactive," or possibly, colloquially, "frozen." See "Current" and "Non Current."

Actuary: Professional authority on the mathematics and statistics relating to mortality and other risks, and rates of premiums, in Assurance and Insurance Companies.

Ademption: A specific legacy of properties which have been disposed of or lost before the testator's death is said to have been "adeemed," and the provision of the will becomes of no effect. Ademption also applies in the case of a general legacy to a child of the testator to the extent of advances made during the testator's lifetime.

Adjusting entry: Any entry made in the books for the purpose of adjustment as between one account or department and another; not made to correct errors, such entries being properly called "correcting" entries. Examples of adjusting entries are: apportionment of managerial expenses over departments; apportionment of wages when a year

end occurs between two pay days; apportionment of Insurance premiums between two years. Sometimes the term is incorrectly used for "closing entries." (q.v.)

CORRESPONDENCE

Box 1260
Montreal, Canada
3rd August 1937

The Chairman of the Terminology Committee,
c/o The Editor,
THE CANADIAN CHARTERED ACCOUNTANT.

Dear Sir:

I have read with great interest the article in connection with the definition of capital and earned surplus in THE CANADIAN CHARTERED ACCOUNTANT for August. On p. 138 it is stated that "Generally dividends can not properly be paid from such credits as are comprised in capital surplus and any distribution of assets to shareholders, charged thereto as dividends, would in fact be impairment of capital." My impression has always been that provided the remaining capital assets were fully worth their book value, a realized capital profit may at any time be distributed by way of dividend to the shareholders—so also could a realized gain from an insurance claim for a fire loss and profit on a resale of treasury stock.

Under the heading "Earned Surplus" part of the decision in Lubbock vs. British Bank of S.A.: Foster vs. New Trinidad Company is quoted. My recollection of that case was that the point at issue was whether or not the accretions to capital, when realized, could be distributed by way of dividends (in confirmation of my comments above), not as to whether accretions to capital should be credited to earned surplus or capital surplus, because the English Companies Act does not distinguish between the two.

I may have misunderstood the printed article but I would appreciate if you could quote any authority which would support the view that realized credits to capital surplus could not generally be distributed by way of dividends.

Yours very truly,

CANADIAN INDUSTRIES LIMITED
R. W. Sharwood,
Assistant Treasurer.

356 Main Street
Winnipeg
11th August 1937

R. W. Sharwood, Esq., C.A.,
Assistant Treasurer,
Canadian Industries, Ltd.,
Box 1260,
Montreal, Que.

Dear Sir:

Replying to your letter of the 3rd August, for which I thank you, first let me say that I do not think there is any real differences in the ideas you have and those expressed in the definitions given.

The sentence you quote from page 138 starts with the word "generally," and was meant so; i.e., the word used was not "invariably" or "exclusively." I take the word generally to mean "common to many or the greatest number; extensive though not universal" (Annandale). You will note that in giving the 4th example of "Capital Surplus" the words are used "But see also definition of Earned Surplus."

In the definition of Earned Surplus it is stated that realized profits from accretions to Capital "should not be brought into Earned Surplus unless and until it is definitely determined that the remaining Capital Assets are fully worth their book value." This, I think, follows the decision in the New Trinidad case, which by the way is quoted on page 108 of the August Canadian Chartered Accountant.

As to the English Companies Act not distinguishing between Capital Surplus and Earned Surplus, my recollection is that the term "Surplus" is not contemplated by that Act, and is very seldom used in English Accounting—at any rate as we use it. The Committee however feel that the general principle is the same. After it is definitely determined by "reference to the whole accounts fairly taken," that the Capital is still intact otherwise, the whole or part of realized accretions may be considered "Earned Surplus," credited to that account, and thus be made available for dividends. Of course the Earned Surplus Account presented to Shareholders should make full disclosure, but this point has nothing to do with the wording of a definition.

The Dominion Companies Act says that "no dividends shall be declared . . . . which will impair the Capital of the Company" (Sec. 83). The 1935 Amendments amplify this to some extent. I submit that the only accounts to which dividends, in the ordinary run of business, can be charged, are Earned Surplus and Distributable Surplus.

Is not the practice suggested of crediting realized accretions to Capital Surplus, at any rate *pro tem*, similar to that of Trustees who keep receipts of a doubtful nature in Capital, and do not distribute to the remainderman until the matter is definitely settled?

Yours faithfully,
JOHN PARTON

Chairman of the Terminology Committee,
Dominion Association of Chartered Acountants.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The discussion of one of the problems which appeared in the Students' Department recently, raised one of the most vexed questions of accounting terminology, namely the use of the terms "reserve" and "reserve fund." It would seem to be quite useless to define these terms by reference to their inherent meaning (if any), and highly desirable to do everything possible to standardize and so render universal, the meanings which the majority of accountants in fact attach to them at the present day. Words are servants not masters and if all people choose consistently to attach to a word a meaning at variance from, or even diametrically opposed to, its etymological meaning little harm is done except to the moral sense of the purist. A case in point is the fact that all English speaking people to-day mean the same thing when they use the verb "prevent" and yet this meaning is very different from the one which attached to that word three hundred years ago when the Anglican prayed: "Prevent us, O Lord, in all our doings."

In the case which we set out to discuss it would seem that in North America the term "reserve fund" is predominantly used in reference to an asset and not to a measure of appropriated profit, while in England it is predominantly used in reference to appropriated profit which is represented by specific assets earmarked on the other side of the balance sheet. The trouble with the American usage is that it leaves us without different and distinct terms by which to refer to valuation or liability reserves on the one hand and appropriations of profit on the other hand, although a clear distinction between these two things is essential to proper understanding of a balance sheet. The accountant may know that a "depreciation reserve" is an entirely different thing from a "general reserve" but the layman is not likely to be greatly helped by these qualifying adjectives. It is to be hoped that those responsible for the development of uniform terminology in accounting will not be unmindful of the existence and needs of the layman, or of the perils (so familiar to the economist) of attaching to words of common speech meanings different from their popular meanings.

Anyone whose school or college career developed in him a dislike (or even mistrust) of mathematics can now exorcise that spirit by the use of Lancelot Hogben's, *Mathematics for the Million* (London, George Allan & Union). He will find this book much more diverting than nine out of ten of the latest novels, and if his mood is a very lazy one he need do no more than enjoy the pictures and diagrams with which the text is so abundantly supplied. The author himself recommends two readings, the first a quick one "to get a bird's-eye view of the social interconnections of 'mathematics,' and the second a more serious effort with pencil, rubber and squared paper in hand." The political and philosophic views which find expression in unexpected places will not be shared by all readers but they are not sufficiently obtrusive to mar the substance of the text.

* * *

STUDENT ASSOCIATION NOTES

ONTARIO

A very successful golf tournament and dance was held by the Ontario Students' Association on Friday, June 25th, at Glen Mawr Golf Club.

Mr. Don Kidd, the past president, presented the prizes as follows:

Low gross: First—J. M. Reid; Second—R. Cavell.

(These two players tied with a score of 87 with J. M. Reid winning the cup on a toss).

Low kickers: First—R. N. Cunningham; Second—D. A. Kidd.

Biggest liar: R. Dollard (net 45).

Sealed hole, low: G. E. Wilson.

Sealed hole, high: H. J. Robinson.

(Mr. Robinson received a pick and shovel).

High score: G. Hutchings.

George Plummer made a presentation to D. A. Kidd in appreciation of his work as President during the previous year.

This was the first function of the Association at which the ladies were present and the innovation was appreciated by those in attendance.

PROVINCE OF QUEBEC

At an organization meeting of the Chartered Accountants Students' Society of the Province of Quebec held on 29th June last the following appointments were made from the general committee members and officers: H. C. Hayes, C.A., Chairman, General Programme Committee; C. N. Knowles, A.C.A. (Eng.), C.A. (Can.), Chairman, Test Examinations Committee; J. R. Hendry, C.A., Chairman, Study Groups Committee; H. B. Savage, B.Com., Chairman Social and Athletic Committee; A. C. Shackell, C.A., Chairman, Publicity and Membership Committee.

The purpose of these early nominations is to allow the various chairmen plenty of time during the summer to formulate their plans, and to be well organized for the busy Autumn season.

The Singles Tennis Tournament organized by Hugh Savage came to a successful conclusion on 30th July, when the finals for the F. W. Sharp Trophy were played. Gordy MacNeil triumphed over Ken Farmer in three straight sets by a score which does not indicate the closeness of the play, 6-2, 6-1, 6-3. It is a coincidence that the two finalists are co-stars on the Victoria Hockey Club team and are employed in the same office. The winner will be presented with the Sharp Trophy, suitably inscribed, at the first general meeting to be held early in the Fall.

The entrance to the Tournament by 31 competitors was rather gratifying, as this was the first attempt of its kind since the Society's reorganization in 1935, and its enthusiastic reception warrants further developments along this line.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by a practising chartered accountant of the Institute from whose examinations the problem is taken and represent his views and opinions. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ALBERTA

INTERMEDIATE EXAMINATIONS (NEW) APRIL 1937. ACCOUNTING NO. 2. QUESTION 1.

1. The following is the trial balance of the Logging and Lumber Company, Limited (operating under a Dominion Charter), at December 31st, 1935:

Accrued Wages		$ 700.00
Accounts Payable		22,400.00
Accounts Receivable	$ 40,500.00	
Bank—Current	1,500.00	
Bank Loan		20,000.00
Buildings (cost), Logging Camp	2.000.00	
Buildings (cost), Sawmill	10,000.00	
Cash on hand	600.00	
Capital (Authorized, 1,000 shares of $100.00 each)		90,000.00
Freight on Lumber	20,700.00	
Goodwill	31,000.00	
Interest and Exchange	2,550.00	
Insurance	3,100.00	
Inventory of Lumber, Jan. 1st, 1935	40,000.00	
Income Tax Adjustment, 1934	550.00	
Lumber Purchased	2,400.00	
Logging Camp Expenses:		
Wages	12,000.00	
Supplies	8,000.00	
Sundry Expenses	6,100.00	
Reserves for Depreciation:		
Logging Camp Buildings		900.00
Sawmill Buildings		4,600.00
Sawmill Equipment		2,000.00
Reserve for Depletion		7,000.00
Royalties on Sales of Timber	6,200.00	
Salaries	10,400.00	
Sundry Overhead Expenses	5,800.00	
Sawmill Equipment and Machinery (Cost)	5,000.00	
Sawmill Expenses:		
Wages	6,000.00	
Supplies and Repairs	5,600.00	
Sundry Expenses	1,000.00	
Sales Tax Department—Sales Tax		1,000.00
Shipping Expenses:		
Wages	2,000.00	

Supplies	1,400.00	
Sundry	700.00	
Sales—Lumber		120,000.00
Sales—Sawdust and Other By-Products		220.00
Selling Commissions (5% of Sales)	6,000.00	
Timber Berths (Cost)	41,000.00	
Unexpired Insurance	1,600.00	
Workmen's Compensation	3,040.00	
Expenditure to date on 1935-1936 Logging Operations	4,400.00	
Earned Surplus, Jan. 1st, 1935		12,320.00
	$281,140.00	$281,140.00

Lumber records give the following information:

On hand, January 1st, 1935	4,050 M board feet
Purchased during year	200 M board feet
Produced during year	4,770 M board feet
Sold during year	4,420 M board feet
On hand December 31st, 1935	4,600 M board feet

Workmen's Compensation consists of a 10% rate on all labor and salaries, and should be charged to the various accounts affected.

A reserve for bad debts is to be made at 10% of the Accounts Receivable.

Depreciation is to be provided as follows:

Buildings—Logging Camp	20 per cent.
Buildings—Sawmill	15 per cent.
Sawmill Equipment and Machinery	15 per cent.

Provide a reserve for income tax amounting to 20% of the net profit.

The lumber inventory is to be valued at the cost of production for the year.

Depletion at the rate of $1.00 per M feet produced is to be provided.

Prepare: Production Account, Trading and Profit and Loss Account, giving costs per M feet for main items and balance sheet as at December 31st, 1935.

SOLUTION

The following journal entries are necessary to adjust the books:

(*a*)

Logging	$1,200.00	
Sawing	600.00	
General Expenses	1,040.00	
Shipping	200.00	
To Workmen's Compensation		$ 3,040.00
Distribution of Workmen's Compensation for the year.		
Bad Debts	4,050.00	
To Reserve for Bad Debts		4,050.00
Ten per cent. reserve on Accounts Receivable.		
Logging—Depreciation	400.00	
Sawing—Depreciation	2,250.00	
To Reserve for Depreciation—Buildings, Logging Camp		400.00

To Reserve for Depreciation—Buildings, Sawmill		1,500.00
To Reserve for Depreciation—Sawmill Equipment and Machinery		750.00
Depreciation for year, as follows: Buildings, logging Camp 20% Buildings, Sawmill 15% Sawmill Equipment and Machinery 15%		
Surplus	2,352.00	
To Reserve for Income Taxes		2,352.00
Twenty per cent. of net profits reserved for income taxes.		
Stock in Trade	46,000.00	
To Trading Account		46,000.00
Inventory, December 31st, 1935: 4,600 M. Board Feet @ $10.00 per M.		
Logging—Depletion	4,770.00	
To Reserve for Depletion		4,770.00
Depletion at $1.00 per M. Board Feet on 4,770 M. Board Feet produced.		

(*b*) LOGGING AND LUMBER COMPANY, LIMITED,
PRODUCTION ACCOUNT,

For the year ending December 31st, 1935.

			Cost per M. Board Feet
Cost of Logging:			
Wages	$12,000.00		$ 2.52
Supplies	8,000.00		1.68
Sundry Expenses	6,100.00		1.28
Workmen's Compensation	1,200.00		.25
Depreciation	400.00		.08
Depletion	4,770.00		1.00
		32,470.00	6.81
Cost of Sawing:			
Wages	6,000.00		1.26
Supplies and Repairs	5,600.00		1.17
Sundry Expenses	1,000.00		.21
Workmen's Compensation	600.00		.13
Depreciation	2,250.00		.47
	15,450.00		
Less Sales of Sawdust	220.00		.05
		15,230.00	3.19
Cost of Production of 4,770 M. Board Feet		$47,700.00	$10.00

(*c*) LOGGING AND LUMBER COMPANY, LTD.
TRADING AND PROFIT AND LOSS ACCOUNT,
For the year ending December 31st, 1935.

			Number of M Board Feet	Value per M Board Feet
Sales		$120,000.00	4,420	$27.15
Less Direct Selling Expenses:				
Freight	$20,700.00			
Selling Commissions	6,000.00			
Royalties	6,200.00	32,900.00	4,420	7.44
		87,100.00	4,420	19.71
Less Shipping Expenses:				
Wages	2,000.00			
Supplies	1,400.00			
Sundry	700.00			
Workmen's Compensation	200.00	4,300.00	4.420	.97
Net Sales Realised		82,800.00	4,420	18.74
Less Cost of Sales:				
Inventory, Jan. 1st, 1935	40,000.00		4,050	9.88
Cost of Production	47,700.00		4,770	10.00
Purchases	2,400.00		200	12.00
	90,100.00			
Less Inventory, Dec. 31st, 1935	46,000.00	44,100.00	4,600	10.00
		38,700.00	4,420	8.76
Less Overhead Expenses:				
Salaries	10,400.00			
Insurance	3,100.00			
Interest and Exchange	2,550.00			
Workmen's Compensation	1,040.00			
Bad Debts	4,050.00			
Sundry Expenses	5,800.00	26,940.00	4,420	6.10
Net Profit		$11,760.00	4,420	$ 2.66

(*d*) LOGGING AND LUMBER COMPANY, LIMITED,
EARNED SURPLUS ACCOUNT,
December 31st, 1935.

Balance, January 1st, 1935		$ 12,320.00
Net Profit for the year		11,760.00
		24,080.00
Less: Income Tax adjustments, 1934	$ 550.00	
Reserve for Income Tax, 1935	2,352.00	2,902.00
		$21,178.00

LOGGING AND LUMBER COMPANY, LIMITED

Balance Sheet, December 31st, 1935.

ASSETS:			
Current assets			
Cash on hand		$600.00	
Cash in Bank..............		1,500.00	
Accounts receivable	$40,500.00		
Less reserve for bad debts	4,050.00	36,450.00	
Inventory of lumber, at cost of production		46,000.00	$ 84,550.00
Fixed assets			
Building, equipment and machinery, at cost	17,000.00		
Less reserves for depreciation	10,150.00	6,850.00	
Timber berths, at cost	41,000.00		
Less reserve for depletion	11,770.00	29,230.00	
Goodwill, at cost		31,000.00	67,080.00
Deferred charges:			
Logging expenses (1935-36) to date		4,400.00	
Unexpired insurance premiums		1,600.00	6,000.00
			$157,630.00
LIABILITIES:			
Current liabilities:			
Bank loan		$20,000.00	
Accrued wages		700.00	
Accounts payable		22,400.00	
Sales tax payable		1,000.00	
Reserve for income tax		2,352.00	$ 46,452.00
Capital and surplus:			
Capital authorized — 1,000 common shares, par value $100.00 each		$100,000.00	
Capital subscribed		90,000.00	
Earned surplus		21,178.00	111,178.00
			$157,630.00

PROBLEM II.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ALBERTA.

FINAL EXAMINATIONS, APRIL, 1937.
ADVANCED ACCOUNTING No. 1, QUESTION 4.

The manager of the X Co., Ltd., consults you in regard to the company's operating results for the years 1935 and 1936. He states that in view of a substantial decline in selling prices of Product B in 1936, he had expected the operations to reflect less profits in 1936 than in 1935, and is therefore doubtful as to the accuracy of the results reflected in the following statements:

Sales		1935		1936
Product A		$ 60,000		$ 70,000
Product B		70,000		95,000
Product E		20,000		10,000
		$150,000		$175,000
Cost of Sales				
Inventory at beginning (at actual costs)	$ 6,000		$ 31,500	
Wages—Direct	55,000		35,000	
Materials—Direct	29,000		22,000	
Manufacturing Expenses.	26,000		22,000	
	$116,000		$110,500	
Less: Inventory at end (at standard costs) ...	31,500		16,500	
		84,500		94,000
Operating Profit ...		$ 65,500		$ 81,000

The inventory valuations at the end of 1934, 1935 and 1936 are as follows:

	1934		1935				1936			
			In Process		Finished		In Process		Finished	
Product	Quan.	Value	Quan.	Value	Quan.	Value	Quan.	Value	Quan.	Value
A	2,500	$2,000	1,400	$ 700	10,000	$10,000	400	$ 200	4,000	$ 4,000
B	2,000	4,000	800	800	10,000	20,000	300	300	6,000	12,000
		$6,000		$1,500		$30,000		$ 500		$16,000

An analysis of the departmental costs is as follows:

1935:	Wages.	Material.	Expenses.
Department 1	$ 26,000	$ 14,000	$ 13,000
Department 2	29,000	15,000	13,000
	$ 55,000	$ 29,000	$ 26,000
1936:			
Department 1	$ 15,000	$ 12,000	$ 8,000
Department 2	20,000	10,000	14,000
	$ 35,000	$ 22,000	$ 22,000

Product A is manufactured in Department 1, Product B results from processing to Product A in Department 2. Product E is a residual by-product from Department 2, and may be shown as miscellaneous income without affecting costs.

A summary of quantities processed for the two years as follows:

1935:	Dept. 1	Dept. 2
In process at beginning of year	......	......
Received into Department	$80,000	$36,600
Spoiled	2,000	......
Transferred to Next Department	36,600	......
Transferred to Finished Goods	40,000	35,800
In Process at end of year	1,400	800
1936:		
In process at beginning of year	$ 1,400	$ 800
Received into Department	90,000	60,000
Spoiled	1,000	......
Transferred to Next Department	60,000	......
Transferred to Finished Goods	30,000	60,500
In process at end of year	400	300

Assume that products in process have incurred one-half the material, wage and manufacturing expenses costs applicable to the finished product produced in the department in which they remain in process.

Prepare any statement, or make any deductions you consider necessary to advise the manager as to the comparative operating results for the two years.

SOLUTION

Statement "I."

COMPUTATION OF COSTS

1935	Dept. 1	Dept. 2
Wages	$26,000.00	$ 29,000.00
Materials	14,000.00	15,000.00
Expense	13,000.00	13,000.00
	53,000.00	57,000.00
From Last Department	—	25,079.60
	53,000.00	82,079.60
Transferred to next Department	25,079.60	
Finished	27,440.00	80,901.20
Remaining in process	480.40	1,178.40
Quantities produced		
Transferred to next Department	36,600.00	
Finished	40,000.00	35,800.00
In process at end in terms of finished goods	700.00	400.00
	77,300.00	36,200.00
Unit Cost this process	.686	1.574
Costs brought forward		.686
	.686	2.260

1936		
Wages	$ 15,000.00	$ 20,000.00
Materials	12,000.00	10,000.00
Expenses	8,000.00	14,000.00
	35,000.00	44,000.00
In process at beginning	480.40	1,178.40
	35,480.40	45,178.40
From Department	—	23,580.00
	35,480.40	68,758.40
To Next Department	23,580.00	
Finished	11,821.80	68,528.75
Remaining in Process	78.60	229.65
Quantities Produced		
Transferred to Next Department	60,000.00	
Finished	30,000.00	60,500.00
In process at end in terms of finished goods	200.00	150.00
	90,200.00	60,650.00
Unit Costs this process	.393	.745
Costs brought forward		.393
	.393	1.138

WORK IN PROCESS INVENTORY—Dept. 2

1935

800 Units @ .686 / .787 = 1.473 = 1178.40

1936

300 Units @ .393 / .3725 = .7655 = 229.65

Statement "II."

COMPARATIVE OPERATING STATEMENTS (to nearest Dollar)
1935—1936

	Product "A"			Product "B"			
1935	Quantity	Per Unit	Total	Quantity	Per Unit	Total	TOTAL
Sales	32,500.00	1.87	$60,000.00	27,800.00	2.52	$70,000.00	$130,000.00
Cost of Sales							
Opening Inventory	2,500.00	.80	2,000.00	2,000.00	2.00	4,000.00	6,000.00
Production (finished)	40,000.00	.68	27,440.00	35,800.00	2.26	80,901.00	108,341.00
	$42,500.00		29,440.00	37,800.00		84,901.00	114,341.00
Less Closing Inventory	10,000.00	.68	6,860.00	10,000.00	2.26	22,600.00	29,460.00
Cost of Sales	32,500.00	.72	22,580.00	27,800.00	2.25	62,301.00	84,881.00
Operating Profit A & B......	32,500.00	1.15	37,420.00	27,800.00	.27	7,699.00	45,119.00
Sales of E							20,000.00
Total Operating Profit							$65,119.00
1936							
Sales	36,000.00	1.94	$70,000.00	64,500.00	1.47	$95,000.00	$165,000.00
Cost of Sales							
Opening Inventory	10,000.00	.68	6,860.00	10,000.00	2.27	22,600.00	29,460.00
Production	30,000.00	.39	11,822.00	60,500.00	1.14	68,529.00	80,351.00
	40,000.00		18,682.00	70,500.00		91,129.00	109,811.00
Less Closing Inventory	4,000.00	.29	1,572.00	6,000.00	1.14	6,840.00	8,412.00
	36,000.00	.47	17,110.00	64,500.00	1.30	84,289.00	101,399.00
Operating Profit A & B....	36,000.00	1.47	52,890.00	64,500.00	.17	10,711.00	63,601.00
Sales of E							10,000.00
Total Operating Profit							$73,601.00

The corrections in figures are attributable to the pricing of Inventories, which is summarized as follows:

1935			
Profits before correction			$65,500.00
Profits after correction			65,119.00
			381.00
Accounted for as follows:			
Inventory at end of 1935			
At Standard		$31,500.00	
At Actual			
Finished	$29,460.00		
In process	1,659.00	31,119.00	
Difference			381.00
1936			
Profits before correction			81,000.00
Profits after correction			73,601.00
			7,399.00
Accounted for as follows:			
Inventory at end of 1936			
At Standard		$16,500.00	
At actual			
Finished	$8,412.00		
In process	308.00	8,720.00	
		7,780.00	
Less difference in inventory at beginning		381.00	
Difference			7,399.00

The management is correct that there has been a decline in the gross profit of Product "B" (due to decline in selling price) but this fact has been more than offset by an increase in volume of both products "A" and "B" and an increase in operating profit of "A" and "B" amounting to $18,500.00. From this must be deducted the decline in sales of Product "E" of $10,000.00. This may be summarized as follows:

STATEMENT ACCOUNTING FOR VARIATIONS IN PROFITS

Product "A"		
Increase in Volume	$	
3,500 units @ 1.15		4,000.00
Increase in Gross Profit (36,000 units at 32c)		11,500.00
Increase in Operating Profit Product "A"		$15,500.00
Product "B"		
Increase in Volume 36,700 units @ 27	$ 9,400.00	
Less Decrease in Gross Profit 64,500 units @ 10	6,400.00	

Increase in Operating Profit Product "B"	3,000.00
	$18,500.00
Less decline in Sales of Product "E"	10,000.00
Net Increase in Operating Profits............	$ 8,500.00